INDEX

PAGE

Docket Entries, National Hosiery Mills, Inc. vs. Commissioner of Internal Revenue, Docket No. 24,640 1

Docket Entries, Grenada Industries, Inc. vs. Commissioner of Internal Revenue, Docket No. 24,571 4

Petitior in Case No. 24,640 8

Exhibit (not marked)—Letter, Commissioner to National Hosiery Mills, Inc., dated 6/2/49, with Statement attached 30

Answer of Respondent in Case No. 24,620 68

Petition in Case No. 24,571 71

Exhibit (not marked)—Letter, Commissioner to Grenada Industries, Inc., dated 6/2/49, with Statement attached 93

Answer of Respondent in Case No. 24,571 130

Findings of Fact and Opinion 135

Decision in Case No. 24,640, entered 3/6/52 186

Decision in Case No. 24,571, entered 3/6/52 187

TRANSCRIPT OF HEARING 189

Motion to consolidate cases Nos. 24,640 and 24,571 for hearing and briefing and Ruling thereon 190

Statement made by Mr. Littleton, Counsel for Petitioners 190

Statement made by Mr. Ponder, Counsel for Respondent 198

Colloquy between Court and Counsel 202

INDEX—Continued

	PAGE
Transcript of Hearing—(Continued)	
Evidence for Petitioners:	
Testimony of Lazure L. Goodman	218
Lazure L. Goodman (Resumed)	262
L. L. Goodman (Resumed)	315
Israel E. Solar	338
A. J. Barskin	379
Statement made by the Court	393
Colloquy between Court and Counsel	395
Evidence for Respondent:	
Testimony of Charles E. Stevens	406
Charles E. Stevens (Resumed)	440
Lazure L. Goodman (Recalled)	453
Colloquy between Court and Counsel	465
Joint stipulation of Counsel regarding Venue on Review, Case No. 24,571	477
Petition for Review in Case No. 24,571	478
Assignment of Errors in Case No. 24,571	485
Notice of Filing of Petition for Review in Case No. 24,571	489
Order of U. S. Court of Appeals, entered 6/23/52 Re Consolidation and Transmission of Testimony Original Exhibits to Appellate Court	491
Joint Motion of Counsel for Consolidation and Transmission of Testimony and Original Exhibits to Appellate Court	493
Petitioner's Designation of Contents of Record on Appeal and Proof of Service thereon	496
Clerk's Certificate, The Tax Court of the United States	499

DOCKET ENTRIES.

NATIONAL HOSIERY MILLS, INC.,
Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 24640.

Appearances:

For Petitioner:
Robert A. Littleton, Esq., Arthur L. Gilliom, Esq.

For Respondent:
Robert C. Whitley, Esq., Roy A. Wentz, Esquire.

1949

Aug. 22—Petition received and filed. Taxpayer notified. Fee paid.

Aug. 22—Request for Circuit hearing in Indianapolis filed by taxpayer. Granted 9/8/49.

Aug. 23—Copy of petition served on General Counsel.

Aug. 29—Entry of appearance of Arthur L. Gilliom as counsel filed.

Sept. 26—Motion to dismiss insofar as it relates to section 722, filed by General Counsel.

Sept. 30—Hearing set October 19, 1949 on respondent's motion.

Oct. 19—Hearing had before Judge Kern on respondent's motion to dismiss. Continued to November 9, 1949.

Oct. 19—Order that the hearing on respondent's motion to dismiss be continued to November 9, 1949, Washington, D. C. entered.

Nov. 9—Hearing had before Judge Kern on respondent's motion to dismiss as to relief under Section 722. Granted.

1949

Nov. 9—Order that respondent's motion is granted and respondent is allowed the usual time from date hereof to move or answer the petition, entered.

Nov. 17—Transcript of Hearing November 9, 1949 filed.

1950

Jan. 3—Answer filed by respondent.

Jan. 10—Copy of answer served on taxpayer, Indianapolis, Ind.

Sept. 6—Hearing set October 30, 1950, Indianapolis.

Sept. 22—Petitioner's motion for a hearing on a limited portion of petition or for a continuance of the hearing set for October 30, 1950 at Indianapolis, filed.

Sept. 25—Hearing set October 11, 1950, Washington, D. C. on petitioner's motion. Copy served.

Oct. 11—Hearing had before Judge Kern on petitioner's motion for a limited hearing. Granted.

Oct. 11—Order, that petitioner's motion is granted and the hearing now set for October 30, 1950 at Indianapolis be heard on a limited portion, entered.

Oct. 31, Nov. 1, 2—Hearing had before Judge Raum on the merits. Oral motion to consolidate docket numbers 24571 and 24640 for hearing granted. Petitioner's brief due December 18, 1950; respondent's brief due January 17, 1951; petitioner's reply brief due February 1, 1951.

Nov. 13—Transcript of Hearing 10/31/50 filed.

Nov. 15—Transcript of Hearing 11/1/50 filed.

Nov. 15—Transcript of Hearing 11/2/50 filed.

Dec. 8—Brief filed by taxpayer. Copy served.

1951

Jan. 18—Motion for leave to file the attached brief, brief lodged, filed by General Counsel. Granted 1/19/51.

Jan. 25—Motion for extension to Feb. 16, 1951 to file reply brief filed by taxpayer. Granted 1/25/51.

Feb. 15—Reply brief filed by taxpayer. Copy served.

Aug. 22—Findings of facts, opinion rendered, J. Raum. Decision will be entered under Rule 50. Copy served.

Oct. 4—Respondent's computation for entry of decision filed.

Oct. 10—Hearing set October 31, 1951, Washington, D. C. under Rule 50.

Oct. 31—Hearing had before Judge Kern on settlement under Rule 50. Referred to Judge Raum.

1952

Mar. 6—Decision entered, Raum, J. Div. 11.

May 23—Stipulation regarding venue on review, filed.

May 29—Petition for review by United States Court of Appeals, Fifth Circuit, with assignments of error filed by General Counsel.

June 17—Proof of service filed. (2)

June 25—Certified copy of an order from the Fifth Circuit consolidating this proceeding with docket number 24571 for the purpose of sending up a single consolidated record, and for transmission of the transcript of testimony, and that the original joint exhibits, petitioner's original exhibits, and respondent's original exhibits be transmitted to the Court of Appeals ten days prior to hearing, filed.

1952

June 26—Motion to enlarge the time to September 20, 1952 to prepare and transmit the record filed by taxpayer.

June 27—Order enlarging time to September 19, 1952 to prepare and transmit the record entered.

Aug. 25—Certified copy of an order from the Fifth Circuit dismissing petition for review filed.

DOCKET ENTRIES.

Grenada Industries, Inc., Petitioner,
v. Docket No. 24571.
Commissioner of Internal Revenue, Respondent.

Appearances:

For Petitioner:
Robert A. Littleton, Esq.

For Respondent:
Robert C. Whitley, Esq., Roy A. Wentz, Esq., Lester M. Ponder, Esq.

1949

Aug. 18—Petition received and filed. Taxpayer notified. Fee Paid.

Aug. 18—Request for Circuit hearing in Memphis, Tenn. or New Orleans, Louisiana filed by taxpayer. 8/30/49 Granted to Memphis, Tenn.

Aug. 19—Copy of petition served on General Counsel.

Sept. 26—Motion to dismiss insofar as it relates to Section 722, filed by General Counsel.

1949

Sept. 30—Hearing set October 19, 1949 on respondent's motion.

Oct. 19—Hearing had before Judge Kern on respondent's motion to dismiss, continued to November 9, 1949.

Oct. 19—Order—that hearing on respondent's motion to dismiss be continued to November 9, 1949 at Washington, D. C., entered.

Nov. 9—Hearing had before Judge Kern on respondent's motion to dismiss as to Section 722—Granted.

Nov. 9—Order: that respondent's motion is granted and respondent is allowed the usual time from date hereof to move or answer the petition, entered.

Nov. 17—Transcript of hearing November 9, 1949 filed.

1950

Jan. 3—Motion for change of place of hearing from Memphis, Tenn. to Indianapolis, Indiana filed by respondent.

Jan. 3—Answer filed by respondent.

Jan. 9—Hearing set January 25, 1950, Washington, D. C. on respondent's motion. Copy of answer hereby served.

Jan. 18—Agreed motion for continuance to March 1, 1950 filed. Granted.

Mar. 1—Hearing had before Judge Disney on respondent's motion for change of place of hearing. Continued.

Mar. 1—Order: that the hearing on respondent's motion for change of place of hearing is continued to May 3, 1950, entered.

May 3—Hearing had before Judge Kern on respondent's motion for change of place of hearing. Granted.

1950

May 16—Transcript of hearing May 3, 1950 filed.

Sept. 6—Hearing set October 30, 1950, Indianapolis, Indiana.

Sept. 22—Petitioner's motion for a hearing on a limited portion of petition or for continuance of the hearing set for October 30, 1950 at Indianapolis, Indiana filed.

Sept. 25—Hearing set October 11, 1950, Washington, D. C. on petitioner's motion. Copy served.

Oct. 11—Hearing had before Judge Kern on petitioner's motion for limited hearing—Granted.

Oct. 11—Order: that petitioner's motion is granted and the hearing now set October 30, 1950 at Indianapolis, Indiana be on a limited portion, entered.

Oct. 31/Nov. 1/Nov. 2—Hearing had before Judge Raum on merits, oral motion to consolidate docket 24571 and 24640 for hearing—Granted. Petitioner's brief December 18, 1950; Respondent's brief Jan. 17, 1951; Petitioner's reply February 1, 1951.

Nov. 13—Transcript of hearing October 31, 1950 filed.

Nov. 15—Transcript of hearing November 1, 1950 filed.

Nov. 15—Transcript of hearing November 2, 1950 filed.

Dec. 8—Brief filed by taxpayer. Copy served. Printed brief received December 18, 1950.

1951

Jan. 18—Motion for leave to file the attached brief, brief lodged, filed by General Counsel. 1/19/51 Granted.

Jan. 25—Motion for extension to February 16, 1951 to file reply brief, filed by taxpayer. 1/25/51 Granted.

Feb. 15—Reply brief filed by taxpayer. Copy served.

1951

Aug. 22—Findings of fact, opinion rendered, Judge Raum, decisions will be entered under Rule 50. Copy served.

Oct. 4—Respondent's computation for entry of decision filed.

Oct. 10—Hearing set October 31, 1951, Washington, D. C. under rule 50.

Oct. 31—Hearing had before Judge Kern on settlement—Rule 50—Referred to Judge Raum. Petitioner's motion to withhold entry of order under Rule 50 filed at hearing. Copy served.

1952

Feb. 28—Motion for leave to file the attached revised and agreed computation, computation lodged, filed by respondent. 3/3/52 Granted. Joint computation filed.

Mar. 5—Motion to withhold entry of order under Rule 50, denied.

Mar. 6—Decision entered, Raum, Judge, Division 11.

May 23—Stipulation regarding venue on review filed.

May 27—Petition for review by U. S. Court of Appeals, Fifth Circuit with assignments of error filed by taxpayer.

May 27—Proof of service filed.

June 25—Certified copy of an order from the U. S. Court of Appeals, Fifth Circuit consolidating with docket 24640 for purpose of sending up a single consolidated record, and for transmission of transcript of testimony. That the original joint exhibits, the petitioner's original exhibits and the respondent's original exhibits to be transmitted to this Court ten (10) days prior to hearing, filed.

1952

June 26—Motion to enlarge time to September 20, 1952 to prepare and transmit the record filed by taxpayer.

June 27—Order enlarging time to September 19, 1952 to prepare and transmit the record entered.

Aug. 15—Designation for transcript of record filed by taxpayer with service thereon.

PETITION.

Filed Aug. 22, 1949.

The Tax Court of the United States

National Hosiery Mills, Inc., Petitioner,
vs. Docket No. 24640.
Commissioner of Internal Revenue, Respondent.

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated June 2, 1949, and as a basis of its proceeding alleges as follows:

1. Petitioner is a corporation organized under the laws of the State of Indiana with its principal office and place of business at 502 N. Davidson Street, Indianapolis, Indiana. The returns of petitioner for the period here involved were filed with the Collector for the District of Indiana.

2. The notice of deficiency, a copy of which is attached hereto and marked Exhibit "A", was mailed to petitioner on the 2nd day of June, 1949.

3. The taxes in controversy are income, declared value excess profits tax and excess profits tax for the calendar years 1940 and 1941; for the period 1/1/42 to 12/26/42; and the period 12/27/42 to 12/31/43 in the amounts of (a) income taxes in the amount of $25,754.14; (b) declared value excess profits tax, in the amount of $5,235.73; and (c) excess profits tax, in the aggregate amount of $51,602.66. The whole amount of such taxes is in dispute.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) Respondent has failed to allow petitioner adequate depreciation, so as to include obsolescence of the functional use of knitting machines in use for the calendar years ending December 31, 1940 and 1941, as well as the periods 1/1/42 to 12/26/42 and 12/27/42 to 12/31/43.

(b) Respondent has erroneously disallowed $2,946.00 paid H. V. Kobin on salary fixed and authorized for the period 1/1/42 to 12/26/42, and $5,976.81 for the period 12/27/42 to 12/31/43.

(c) Respondent has erroneously, arbitrarily and capriciously allocated and included as net income of petitioner an item of net income of Grenada Hosiery Mills (a separate organization) the amounts of $3,819.94, for the year ended December 31, 1940; the amount of $6,329.43, for the year ended December 31, 1941; the amount of $4,-581.47 for the period 1/1/42 to 12/26/42; and the amount of $5,394.33, for the period 12/27/43.

(d) Respondent has erroneously, arbitrarily and capriciously allocated and included as net income of peti-

tioner an item of net income of Abar Process Company (a separate organization) the amount of $12,335.43, for the period 1/1/42 to 12/26/42; and the amount of $16,-071.71 for the period 12/27/42 to 12/31/43.

(e) Respondent has improperly and erroneously determined that a 5% penalty, pursuant to Section 291(a) of the Internal Revenue Code be proposed against petitioner on account of late filing of excess profits tax return for the period 12/27/42 to 12/31/43 in the amount of $1,724.25.

(f) Respondent errs in proposing to assess deficiencies in excess-profits tax against petitioner for the periods in question without giving due and proper consideration to application filed by petitioner on Form 991 for relief under the provisions of Section 722(a), (b) (4) and (5) of the Internal Revenue Code—pursuant to claims for refund of $28,234.00 of excess profits tax paid as a basis of such application for relief. Therefore, the deficiencies in excess profits tax proposed are excessive and discriminatory within the meaning of Section 722(b) of the Code.

5. The facts upon which petitioner relies as a basis of this proceeding are as follows:

(a) During the taxable periods involved herein petitioner was engaged in the business of knitting hosiery. The machinery in use was of a make that had more or less become obsolete on the basis of its original design and/or construction, but because of the inability of petitioner to obtain more modern machinery, or place orders therefor, it undertook to and did repair, change and modernize its knitting machines at substantial cost for improvements.

The repairs and improvements made to said knitting machines were not of a nature that extended their useful life, but merely arrested somewhat the matter of machines becoming obsolete. There was functional obsolescence with respect to the changed character of said machines in the category of the improvements made thereon becoming functionally obsolete. Therefore, an allowance for depreciation on said machines should take into consideration the occurrence of obsolescence in the redesigned aspect of their functional utility after extensive changes to prevent them becoming obsolete at a time when replacement by new machines was impracticable, if not impossible.

(b) During the periods 1/1/42 to 12/26/42 and 12/27/42 to 12/31/43 H. V. Kobin was a valued officer and employee of petitioner under an arrangement whereby the basic salary paid him be supplemented by the payment of a bonus salary measured by the value of the services of the said H. V. Kobin. The amount fixed as compensation for the services of the said H. V. Kobin, including the bonus part of such compensation, was deemed reasonable—and the amount thereof was duly and regularly paid. The said H. V. Kobin had been an officer and in the employment of petitioner for more than ten years prior to January 1, 1942; and it was due substantially to the services rendered petitioner by the said H. V. Kobin that volume of sales of its products was what they were during the periods in question. During the period 1/1/42 to 12/26/42 the said H. V. Kobin—being of military age within the meaning of the Arms Service Act of Congress—volunteered his services to the United States in the interest of national defense. During the period of military service of H. V. Kobin, as aforesaid, the rate and basis of salary due to him by petitioner was continued to be paid. It was deemed that the said H. V. Kobin had

earned the right to receive such payments; that it would enable him to better support his family; and that when the emergency necessitating his joining the Armed Services of the United States was over, he would return to the services of petitioner. In view of the foregoing facts, and in harmony with the declared policy of respondent in such cases, it is error for respondent to disallow $2,946.00 of compensation paid H. V. Kobin for the period 1/1/42 to 12/26/42, and $5,976.81 for the period 12/27/42 to 12/31/43.

(c) In the explanatory statement accompanying the deficiency notice of June 2, 1949 respondent makes the following arbitrary and capricious statements of the grounds for invoking the provisions of Section 45 of the Internal Revenue Code with respect to the net income of "Grenada Hosiery Mills" that he purports to "allocate" as taxable income of petitioner, viz:

"Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to 'Grenada Hosiery Mills', a purported partnership, have been allocated to you and included in your net income for the taxable years and in the amounts set forth below, to-wit:

Year—1940	$3,819.94
Year—1941	6,329.43
Year—1942	4,581.77
Year—1943	5,394.33

In the alternative it is held that said purported partnership is without substance and the said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code."

(d) Grenada Hosiery Mills is a partnership organization and is composed of members who are not owners of petitioner in the proportion or relationship that authorizes or permits respondent to make the allocation as proposed. Moreover, Grenada Hosiery Mills operates independently with respect to the business it transacts and the only relation that it had with petitioner during the periods in question was evidenced by an agreement for work to be done on unfinished hosiery that Grenada Hosiery Mills had acquired, was in possession of and had taken over for sale to the trade when finished as hosiery suitable for wear. During the periods in question petitioner owned and operated a knitting mill for the manufacture of hosiery, and in conection with its knitting mill petitioner also owned and operated what is known in the industry as a "finishing mill". Grenada Hosiery Mills was in the market for the services of a "finishing mill" to complete the manufacturing processes of the hosiery it had in the grey for sale to the trade when finished. Petitioner had no interest in and/or title to the grey hosiery of Grenada Hosiery Mills, and had not performed any of the manufacturing processes thereof in the grey. Furthermore, it was usual and customary for petitioner in the business it transacted to enter into agreements, contracts or arrangements with persons having hosiery in the grey to finish them by its "finishing mill". The price that petitioner charged Grenada Hosiery Mills for finishing its grey hosiery was the usual and customary charge for such services, and in rendering such services petitioner did not acquire the right to any interest in the hosiery of Grenada Hosiery Mills, nor is petitioner entitled to any part of the profits realized by the said Grenada Hosiery Mills in the sale of its hosiery.

(e) Respondent has arbitrarily and capriciously sought to apportion the profits realized by Grenada Rosiery

Mills from the sale of its hosiery between the cost to it of the grey hosiery and the amount paid petitioner for finishing said hosiery for trade sales, and pursuant to such a formula it is proposed that a portion of the profits realized by Grenada Hosiery Mills from the sale of hosiery be allocated as a part of the net income of petitioner. There is not the slightest authority for the proposal of respondent within the true meaning and purpose of Section 45 of the Internal Revenue Code. Petitioner is advised that Grenada Hosiery Mills was during the periods in question an organization of a sui juris character, and as such possessed plenary powers to transact the business undertaken by it and carried on for the purpose of gain and profit to its members. Petitioner is advised, also, that respondent recognizes that Grenada Hosiery Mills is a sui juris organization, but for arbitrary and capricious purposes of the allocation of its net income as proposed, the profits of its business accruing as taxable income of members—as provided by Sections 181 and 182 of the Code—are proposed to be limited by respondent to 10% of the contributed capital of said partnership. This, petitioner avers, is substantial evidence of the arbitrary conduct of respondent; and to say the least of such conduct, it is in conflict with the proposal of respondent that Grenada Hosiery Mills is "without substance" and that its operating profits should be "allocated" as net income of third persons with whom it might of necessity be desirous of transacting business on a fair and free basis customarily carried on in the field of commerce and trade.

(f) The arbitrary and capricious character of the conduct of respondent in making allocation to petitioner of a fractional part of the net income of Grenada Hosiery Mills is clearly demonstrated by the alternative aspect of his proposal that he deems Grenada Hosiery Mills to

be "without substance"; and notwithstanding the finding that net income was earned by the said Grenada Hosiery Mills from the business transacted, it is nevertheless a part of the net income of petitioner within the meaning of Section 22(a) of the Code. Section 45 of the Code is not so obscure in its provisions as to cause doubt in the mind of respondent with respect to its administration; nor is there obsurity in the meaning of Section 22(a) of the Code when applied in the light of Sections 181 and 182 of the Code to the effect that net income of a partnership business is to be taken into account in computing tax liability of its members or owners. Petitioner was in no category of an owner of the business, property or inventories of Grenada Hosiery Mills.

(g) Petitioner avers that at the time it entered into business relations with Grenada Hosiery Mills it took the precaution of an ordinary person to examine into its status as a business organization and the qualification of its personnel to transact the business undertaken by agreements with petitioner, and found that the Grenada Hosiery Mills was a duly and regularly organized partnership under the laws of Indiana. Therefore, based upon knowledge gained by petitioner in the conduct of its business petitioner avers that the determination of respondent that Grenada Hosiery Mills is a "purported organigation without substance" is contrary to facts known to petitioner, of which facts respondent is not without knowledge in the proper exercise of the duties of his office.

(h) In the explanatory statement accompanying the deficiency notice of June 2, 1949, respondent makes the following statement of the grounds for invoking the provisions of Section 45 of the Code with respect to his proposal to allocate to petitioner items of net income of

"Abar Process Company" directly and/or alternately, viz:

"Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to 'Abar Process Company', a purported partnership, have been allocated to you and included in your net income for the taxable years and in the amounts set forth below, to-wit:

Year—1942	$12,335.43
Year—1943	16,071.71

In the alternative it is held that the said purported partnership is without substance and that said portion of the income which were attributed to said purported partnership are taxable to you under the provisions of Section 22 (a) of the Internal Revenue Code."

(i) The Abar Process Company is a partnership composed of persons who are not stockholders and/or owners of petitioner in the sense that two related businesses are owned, operated and controlled by the same interests; and even though the two organizations be susceptible of an unity of ownership, the business of each is not related to the other sufficiently to justify the allocation of net income as proposed. Nor may respondent, in the alternative, regard the Abar Process Company as a "related business organization without substance" so as to escape the command of Sections 181 and 182 of the Code that tax on the net income of a partnership business be the liability of those who own the business organization.

(j) The business activity of the Abar Process Company is that of reclaiming from waste material resulting from the manufacture of hosiery yarn to be found in such waste

material and rewinding it on spools so as to permit subsequent use. The waste material from which Abar Process Company reclaims yarn for subsequent use is gathered from many sources, paid for at the market price for such waste material, and a small proportion of the waste material gathered by Abar Process Company for use in its business during the periods in question was purchased by it from petitioner at a fair price. Some portion of the yarn reclaimed by Abar Process Company from the waste material it processed was sold by it to petitioner at a fair price; but that is not to say, as respondent proposes, that the business of each organization is so closely related that the net income of each must be consolidated in the proportions proposed, nor that the net income of Abar Process Company should be allocated proportionately to and consolidated with the net income of petitioner in the ratio that Abar Process Company might see proper to buy waste material from the grey mill of petitioner for reclaiming and rewinding yarn to be salvaged therefrom. In computing the tax liability of members of the partnership of Abar Process Company petitioner is advised that respondent proposes to limit distributable profits to 10% of capital contributed by members, nevertheless the basis of his alternative proposal is that Abar Process Company is "without substance". Respondent seems to concede the arbitrary and capricious nature of his conduct within the meaning of Section 45 of the Code by seeking an alternative basis therefor in conflict with the provisions of Sections 181 and 182 of the Code so as to carry out the command of Section 22(a) of the Code. The sections of the Code upon which respondent says he bases his determination in the alternative are not so obscure as to hide their true meaning to respondent; and when respondent is authorized to exercise discretion—as he may do under the provisions of Section 45 of

the Code—he should not doubt the wisdom of his direct action by resorting to alternative basis that demonstrates arbitrary and capricious conduct within the meaning of Sections 181 and 182. It appears to be the purpose of respondent to increase the burden of tax on net income of Abar Process Company by allocating it as income of petitioner so as to impose an "excess profits tax" liability thereon; otherwise, the burden of tax thereon as provided by Sections 181 and 182 and/or Section 22(a) of the Code when regarded as net income of Abar Process Company is substantially less than the deficiencies proposed thereon against petitioner.

(k) Petitioner did not wilfully or negligently fail and refuse to file an excess profits tax return for the period ending December 31, 1943 within the meaning of Section 291(a) of the Internal Revenue Code; but the failure in that respect, if any, was due to a reasonable cause.

(l) Petitioner has paid to the Collector of Internal Revenue for the Collecting District of Indiana the following amounts of excess profits tax as proposed against it for the periods aforesaid, to-wit: For the calendar year 1941, the amount of $11,935; for the period 1/1/42 to 12/26/42, the amount of $2,650; and for the period 12/27/42 to 12/31/43, the amount of $13,649. Immediately after the payment of excess profits taxes as aforesaid petitioner filed a claim for the refund thereof pursuant to an application for relief under Section 722 of the Internal Revenue Code as provided by Form 991, United States Treasury Department. The application for relief under Section 722 of the Code was supported fully by data; and the grounds of the application were set forth in a leading statement accompanying the application as follows:

"The above-named taxpayer hereby makes application for relief from the burden of excess and discriminatory tax that results from the taxable years ended December 31, 1940 to 1943, inclusive, when the tax for each of said years or accounting periods is computed under Subchapter E, Paragraph I of the Internal Revenue Code without the benefit of Section 722 of said Code.

Application of Section 713:

Section 713(b) of the Code reads as follows:

'(1) Definition—As used in this section the term "base period"—

(A) If the corporation was in existence during the whole of the forty-eight months preceding the beginning of its first taxable year under this subchapter, means the period commencing with the beginning of its first taxable year beginning after December 31, 1935, and ending with the close of its last taxable year beginning before January 1, 1940; and

(B) In the case of a corporation which was in existence during only part of the forty-eight months preceding the beginning of its first taxable year under this subchapter, means the forty-eight months preceding the beginning of its first taxable year under this subchapter.'

The taxpayer was organized on August 4, 1928 under the laws of the State of Indiana for the purpose of engaging in business of knitting hosiery, and is a corporation ordinarily entitled to excess-profits credit—based upon income—as provided by Section 713 of the Code. However, the average base period net income of the taxpayer is an adequate standard of normal earnings that should have been realized.

Invocation of Section 722(b)(4):

Section 722(b)(4) and (5) of the Code reads as follows:

'(4) the taxpayer, either during or immediately prior to the base period, commenced business or changed the character of the business and the average base period net income does not reflect the normal operation for the entire base period of the business. If the business of the taxpayer did not reach, by the end of the base period, the earning level which it would have reached if the taxpayer had commenced business or made the change in the character of the business two years before it did so, it shall be deemed to have commenced the business or made the change at such earlier time.'

* * * * * * * *

'(5) of any other factor affecting the taxpayer's business which may reasonably be considered as resulting in an inadequate standard of normal earnings during the base period and the application of this section to the taxpayer would not be inconsistent with the principles underlying the provisions of this subsection, and with the conditions and limitations enumerated therein.'

During the base period, and in about the month of April, 1937, the corporate structure of the taxpayer was reorganized by a merger of the property, business and assets of the Indianapolis National Corporation into the taxpayer; and the operation of the business of the taxpayer for the production of full-fashioned ladies hosiery was thereafter completely changed in the following particulars, viz:

1. In the month of April, 1937 the management and operation policies of the business of the taxpayer were changed as follows:

(a) J. A. Goodman resigned his official position as Chairman of the Board of the Real Silk Hosiery Mills of Indianapolis, Indiana, and was elected President of taxpayer in charge of production.

(b) L. L. Goodman resigned his official position as Treasurer of the Real Silk Hosiery Mills of Indianapolis, Indiana, and was elected Treasurer of the taxpayer in charge of purchases of materials, etc.

(c) H. V. Kobin who had theretofore been President of the Indianapolis National Corporation, with the responsibility of production, purchases and sales, was elected Vice-President and put in charge of sales.

2. In the month of April, 1937, the method of operation for the sale of the products of the taxpayer was changed as follows:

(a) The taxpayer severed its relations with the 'Trojan' department of the Real Silk Hosiery Mills as a sales agency for its products, and established a sales organization of its own under the direction of H. V. Kobin, Vice President.

(b) The taxpayer adopted trade-marks and trade-brands to identify the 'National' quality of the full-fashioned hosiery it produced; copyrighted a 'fit service' chart for the convenience of customers of its hosiery, and knitted the hosiery so that the sizes selected by the use of the copyrighted chart would fit the wearer perfectly.

3. When the changes were made in the method of operation as stated in paragraph 2 above, the taxpayer expected a volume of grey hosiery from the following sources to be finished by it and distributed to the trade through its sales organization, viz:

(a) The Grenada Industries, Inc. was in the process of being organized in April, 1937 for the production of full-fashioned hosiery in the grey to be finished at the mills of taxpayer and sold under the 'National' trade-brands and trade-marks; and in order to be prepared to render finishing services for the grey hosiery produced by Grenada Industries, Inc. taxpayer gave up contracts with other mills to finish the grey hosiery they produced for sale to the trade.

(b) When the taxpayer made the change in its operations in April, 1937, by the establishment of a sales organization for the full-fashioned hosiery it produced, and was prepared to render finishing services on grey hosiery produced by other mills not having the facilities of a finishing department or a sales organization, it was in a position to buy full-fashioned hosiery in the grey to be finished by it and sold to the trade.

(c) If the changes in the methods of operation that were made by taxpayer in the month of April, 1937, aforesaid, had been made two years before they were the volume of business that the taxpayer could have transacted during the base period years, with respect to grey hosiery finished by it for sale to the trade, would have resulted in a substantial profit to taxpayer during the base period from the finishing and sales services rendered.

(d) Due to factors over which the taxpayer had no control, the grey hosiery which it expected to be supplied by Grenada Industries, Inc. for finishing and sale services was delayed beyond a reasonable period after the taxpayer made the changes in its operations in April, 1937; and because of such delays the taxpayer was not able to earn in the base period years the profits it fully expected from the changes made in the methods of its operations.

4. The taxpayer, by authority of the Dupont Company, began to test the utility of nylon yarn for the production of full-fashioned ladies hosiery in the latter part of the base period year 1939 to the following extent, viz:

(a) Nylon yarn for knitting hosiery was being distributed by the Dupont Company during the year 1939 to a select group of knitting mills for a test of its use in the production of hosiery as a substitute for silk yarn.

(b) The taxpayer was one of the mills selected to run tests on the use of nylon yarn for the production of full-fashioned ladies hosiery and for several months prior to the close of the base period year 1939 a substantial quantity of hosiery had been produced at the mill of the taxpayer by the use of nylon yarn. Hosiery knitted by the use of nylon yarn was not offered for sale until about May 15, 1940, but in the tests run by taxpayer during the base period of 1939, the utility of nylon yarn was proven to be satisfactory.

5. The taxpayer, in the early part of the year 1938, commenced the work of converting its knitting machines from a double-unit to a single-unit operation in the following manner, viz:

(a) The knitting machines acquired in the latter part of the year 1937 for use by the Grenada Industries, Inc. aforesaid, were manufactured in Germany. They were a single-unit machine, and something new in the hosiery industry as conducted in the United States.

(b) In the early part of the year 1938 the taxpayer employed machinists to convert its double-unit knitting machines to a single-unit operation; and by the close of the calendar year 1939, in the base period, the double-unit machines of the taxpayer had been converted to a single-unit operation.

(c) The conversion—by mechanical processes—of the double-unit machines of the taxpayer to a single-unit operation, as aforesaid, affected substantial savings in the manufacturing cost of hosiery; and also resulted in the production of hosiery that had a decided sales appeal to the ultimate user. The conversion also increased the production capacity of the former double-unit machines. Hosiery produced by a single-unit operation sold for a better price per dozen than hosiery produced by a double-unit operation.

6. Up to April, 1937 the taxpayer was finishing low gauge hosiery in the grey; whereas, high gauge hosiery commands a better price when finished for sale to the trade, and high gauge hosiery is more readily saleable to the trade than low gauge hosiery. The new management of taxpayer effected this change in operations for the production of high gauge hosiery, and if such change had been made two years sooner taxpayer would have realized a substantial profit in the base period from the services of finishing and sale of high gauge hosiery.

History of Operations:

The business of the taxpayer was operated as a mill for the production of the ordinary quality of full-fashioned ladies hosiery until plans for its expansion were gotten under way in the early part of the base period year 1937. The taxpayer had not adopted a brand for its hosiery, nor was its capacity of production such that a sales organization for the sale of its hosiery under a brand-name could be established from an economical standpoint.

Effect of Changes in the Base Period:

The changed character of the business of the taxpayer did not reach, by the end of the base period, the earning level which it would have reached if the changes made in the character of operation, as aforesaid, had started two years before they were adopted.

There is attached hereto Exhibits and supporting data schedules that reflect:

(1) The actual operations of the taxpayer during the base period years as shown by its books. Identified as Exhibit 'A'.

(2) The operations that the taxpayer could have reasonably expected from the changes made during the base period of the changes had been made two years before they were. Identified as Exhibit 'B'.

(3) The operations that the taxpayer could have expected from the purchase of grey hosiery to be finished by it for sale to the trade under the 'National' trade brands and trade-marks, pursuant to the changes made in its methods of operation. Identified as Exhibit 'C'.

(4) The operations that the taxpayer could have reasonably expected from the conversion of its knitting machines from a double-unit operation to a single-unit operation during the base period if the changes made by the conversion had been started and completed two years before they were. Identified as Exhibit 'D'.

(5) The operations that the taxpayer could have reasonably expected from the use of nylon yarn for the knitting of hosiery if the experimental use of such yarn during the base period had been started two years before it was. Identified as Exhibit 'E'.

There were also changes in management, methods of operation and merchandising of goods manufactured that blend in with the foregoing enumerated specific changes during the base period which had the effect of eliminating factors affecting the taxpayer's business during the base period; and if such factors had been eliminated by changes in methods of operation two years before they were, a normal standard of earnings, as reflected by the exhibits attached hereto, could have been realized.

Prior to the time that L. L. Goodman and J. A. Goodman took charge of the active operations of the taxpayer in the capacity of production manager in the case of J. A. Goodman and manager of purchases in the case of L. L. Goodman, these gentlemen had been officials and stockholders of the Real Silk Hosiery Mills of Indianapolis, Indiana. The positions these gentlemen took with the taxpayer's operations during the base period were of great importance from the standpoint of the changes being made in the character of its business, and the end result of those changes.

Some of the changes inaugurated during the base period were immediately beneficial from the standpoint of the system of operations, but with respect to actual production of goods for sale, the processes of putting material changes into effective operation were slow. For illustration—(a) the machinery of the new mill for the production of grey hosiery at Grenada, Mississippi, had to be installed, tested and broken-in by a shake-down period of operation; (b) the conversion of knitting machines from a double-unit to a single-unit operation took time—and during the time of conversion work the machines being converted were idle from a production standpoint; and (c) the Dupont Company, that discovered the processes of producing nylon yarn, would not consent to its use for the knitting of hosiery for sale to the trade until its utility and acceptance by the trade as a substitute for silk was thoroughly tested and demonstrated.

During the latter part of the base period years the taxpayer was in the flux of the changes being made in the character of operations from those operations conducted prior to and in the first part of the base period—none of which changes are inconsistent with the principles of relief underlying the provisions of Section 722 of the Code. But all of which changes were made during the base period years. The changes specified above are basic within the meaning of Section 722(b)(4) and (5) of the Code; and by the exhibits and supporting schedules of data attached hereto, the normal earnings to be used as the 'constructive average base period net income' of the taxpayer are reflected with clarity.

There are also attached hereto calculations showing the tax computed under Subchapter E, Paragraph I of the Internal Revenue Code without the benefits of Section 722

of the said Code is excessive and discriminatory. It is clearly demonstrated by the exhibits and supporting schedules attached hereto, that the actual average base period net income of the taxpayer per books is an inadequate standard of normal earnings for the computation of the excess-profits tax credit. During the current years covered by the claim the taxparer was realizing the benefits of the changes of the base period years; and without the benefits of the credits claimed, the tax computed against net income for the current years appears excessive and discriminatory."

(m) The respondent, acting through the Excess-Profits Tax Council of his office, has taken no specific action on petitioner's application for relief; nor is there any reference made in the deficiency notice of June 2, 1949 to said application for relief; and/or claims for refund of excess profits taxes paid as a basis for filing such application. It is not the purpose of petitioner to abandon its application for relief under the provisions of Section 722 of the Code and upon the grounds stated in the application for relief. If a review by this Honorable Court of said application, as filed and perfected in respondent's office, is premature because of the failure of respondent to make a decision thereon sooner than the date of his deficiency notice herein, petitioner requests that it be allowed the privilege of filing an amendment to this petition so that final action taken by respondent on petitioner's application for relief may be reviewed by this Honorable Court as provided by law.

Wherefore, petitioner prays:

1. That the Court hear this appeal on the issues, matters and questions presented and/or necessarily involved with respect to the deficiencies in tax claimed;

2. That the Court make findings of fact and decision on each issue presented in the light of the proof submitted;

3. That the determination of respondent be held to be erroneous, arbitrary and capricious in so far as he undertakes to make an allocation to petitioner of net income of another under the provisions of Section 45 of the Code; and

4. That relief which petitioner is entitled to pursuant to its application therefor under the provisions of Section 722 of the Code be granted on the grounds relied upon herein.

5. That petitioner be given such other, further and general relief that it is entitled to in the premises.

ROBERT A. LITTLETON,
(Robert A. Littleton),
Attorney for Petitioner.

1021 Tower Building,
Washington, D. C.

Of Counsel:
ARTHUR L. GILLIOM,
Suite 1342 Consolidated Building,
Indianapolis, Indiana.

State of Indiana,
Marion County. ss.

J. A. Goodman makes oath in due form of law and says that he is President of petitioner named herein; that he has read over the foregoing petition, is familiar with the facts stated therein, and that they are true to the best of his knowledge, information and belief.

J. A. GOODMAN.

Subscribed and sworn to before me this the 19 day of August, 1949.

DOROTHY PLUMMER,
(Dorothy Lummer),
(Seal) Notary Public.

My commission Expires Feb. 15, 1950.

Treasury Department,
Internal Revenue Service,
Rm. 600, 309 W. Washington St.,
Indianapolis 4, Indiana.

Indianapolis Division. June 2, 1949.

National Hosiery Mills, Incorporated,
502 North Davidson Street,
Indianapolis, Indiana.

Gentlemen:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1940 and December 31, 1941 and year January 1, 1942 to December 26, 1942, discloses a deficiency of $25,754.39, and that the determination of your declared value excess profits tax liability for the taxable year ended December 31, 1940 and year January 1, 1942 to December 26, 1942 and year December 27, 1942 to December 31, 1943, discloses a deficiency of $5,235.73, and that the determination of your excess profits tax liability for the taxable year ended December 31, 1941 and year January 1, 1942 to December 26, 1942 and year December 27, 1942 to December 31, 1943, discloses a deficiency of $51,602.66 and penalty of $1,724.25 for the taxable year December 27, 1942 to December 31, 1943, and that the determination of your income tax lia-

bility for the taxable year December 27, 1942 to December 31, 1943, discloses an overassessment of $4,734.54, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Indianapolis, Indiana. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

GEO. J. SCHOENEMAN,

Commissioner,

By (Signed) ROBERT E. WILSON.

IT:C:LED.

STATEMENT.

National Hosiery Mills, Incorporated,
502 North Davidson Street,
Indianapolis, Indiana.

Tax Liability for the Taxable Years ended December 31, 1940, December 31, 1941, the year January 1, 1942 to December 26, 1942 and the year December 27, 1942 to December 31, 1943.

Year	Liability	Assessed	Over-assessment	Deficiency	Penalty
		Income Tax.			
1940	$ 10,853.07	$ 3,144.14		$ 7,708.93	
1941	20,152.24	12,641.92		7,510.32	
1-1-42 to 12-26-42	17,883.03	7,347.89		10,535.14	
12-27-42 to 12-31-43	16,772.68	21,507.22	$4,734.54		
Totals	$ 65,661.02	$44,641.17	$4,734.54	$25,754.39	
		Declared Value Excess-Profits Tax.			
1940	$ 1,794.24	$ None		$ 1,794.24	
1-1-42 to 12-26-42	1,870.81	None		1,870.81	
12-27-42 to 12-31-43	1,570.68	None		1,570.68	
Totals	$ 5,235.73	$ None		$ 5,235.73	

	Excess-Profits Tax.				
1941	$ 14,467.34	$ None		$14,467.34	
1-1-42 to 12-26-42	2,650.24	None		2,650.24	
12-27-42 to 12-31-43	34,485.08	None		34,485.08	$1,724.25
Totals	$ 51,602.66	$ None		$51,602.66	$1,724.25
Grand Totals	$122,499.41	$44,641.17	$4,734.54	$82,592.78	$1,724.25

In making this determination of your income, declared value excess profits and excess profits tax liability and penalty, careful consideration has been given to the report of examination dated May 7, 1945, to your protest dated August 28, 1945, to the statements made at the conferences held on April 27, 1948, June 25, 1948 and September 13, 1948 and to your claim for refund filed on July 23, 1945.

Inasmuch as your excess-profits tax return for the year December 27, 1942 to December 31, 1943 was not filed within the time prescribed by law, 5 per centum of the tax has been added thereto in accordance with the provisions of Section 291 (a) of the Internal Revenue Code.

Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Grenada Hosiery Mills", a purported partnership, have been allocated to you and included in your net income for the taxable years and in the amounts set forth below, to-wit:

Year—1940	$3,819.94
Year—1941	6,329.43
Year—1942	4,581.77
Year—1943	5,394.33

In the alternative it is held that said purported partnership is without substance and the said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Abar Process Company," a purported partnership, have

been allocated to you and included in your net income for the taxable years and in the amounts set forth below, to-wit:

Year—1942	$12,335.43
Year—1943	16,071.71

In the alternative it is held that said purported partnership is without substance and that said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of Section 22(a) of the Internal Revenue Code.

The overassessment shown herein should not be regarded as finally determined. When final determination has been made, the overassessment to the extent of the amount allowable will be made the subject of a certificate of overassessment, which will reach you in due course through the office of the Collector of Internal Revenue for your district, and will be applied by that official in accordance with section 322 (a) of the Internal Revenue Code, provided that you have fully protected yourself against the running of the statute of limitations with respect to the apparent overassessment referred to in this letter, by filing with the Collector of Internal Revenue for your district a timely claim for refund on Form 843.

A copy of this letter and statement has been mailed to your representatives, Mr. Arthur L. Gilliom, Consolidated Building, Indianapolis 4, Indiana, Mr. Robert A. Littleton, Tower Building, Washington, D. C. and Messrs. Charles R. Stevens and Milton Elrod, Jr., Circle Tower, Indianapolis 4, Indiana, in accordance with the authority contained in the Power of Attorney executed by you and on file with this office.

Adjustments to Net Income.

Taxable Year ended December 31, 1940.

Net income as disclosed by return	$19,564.12
Unallowable deductions and additional income:	
(a) Depreciation	24,137.84
(b) Net operating loss	397.95
(c) Amortization of reorganization expense	354.24
(d) Grenada Hosiery Mills	3,819.94
Total	$48,274.09
Nontaxable income and additional deductions:	
(e) Capital stock tax	$ 1,250.00
Net income adjusted	$47,024.09

Explanations of Adjustments.

(a) It is determined that the deduction of $31,434.59 claimed in your return for depreciation under the provisions of section 23(l) of the Internal Revenue Code is overstated by the amount of $24,137.84.

(b) It is determined that the net operating loss deduction of $24,342.47 claimed on line 26 of your income tax return under the provisions of section 23(s) and section 122 of the Internal Revenue Code should be adjusted by the disallowance of the following items in the year 1939:

Reorganization expense	$354.24
Capital stock tax	35.00
Dividends received credit	8.71
	$397.95

(c) It is determined that the deduction of $354.24 claimed by you for amortization of reorganization expense is not allowable under the provisions of section 23(a) or any other Section of the Internal Revenue Code.

(d) Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Grenada Hosiery Mills," a purported partnership, have been allocated to you and included in your net income for the taxable year 1940 in the amount of $3,819.94.

In the alternative it is held that said purported partnership is without substance and the said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

(e) It is determined that a deduction of $1,250.00 is allowable under the provisions of section 23(c) and section 43 of the Internal Revenue Code for accrued capital stock tax.

Computation of Tax.

Taxable Year ended December 31, 1940.

Declared Value Excess-Profits and Declared Value Excess-Profits Defense Tax Computation.

Value of capital stock as adjusted for year ended June 30, 1940	$267,380.71
Net income for declared value excess-profits tax computation	47,024.09

Less: Dividends received credit	8.71
Balance of net income	$47,015.38
Less: 10 percent of capital stock declared value	26,738.07
Net income subject to declared value excess-profits tax	$20,277.31
Amount taxable at 6 percent	13,369.04
Amount taxable at 12 percent	$ 6,908.27
Declared value excess-profits tax	802.14
Declared value excess-profits tax	828.99
Total declared value excess-profits tax	1,631.13
Declared value excess-profits defense tax	163.11
Total declared value excess-profits and declared value excess-profits defense taxes	$ 1,794.24

Income Tax Computation.

Taxable Year ended December 31, 1940.

Net income for declared value excess-profits tax computation	$47,024.09
Less: Declared value excess-profits and declared value excess-profits defense taxes	1,794.24
Net income	$45,229.85
Less: Dividends received credit	8.71
Normal-tax net income	$45,221.14
Income tax (22.1% of $45,221.14)	9,992.87

Income defense tax (1.9% of $45,221.14)	859.20
Total income and income defense taxes	$10,853.07
Total income and income defense taxes assessed:	
Original list, Account No. 421412	3,144.14
Deficiency	$ 7,708.93

Adjustments to Net Income.

Taxable Year ended December 31, 1940.

Invested Capital Method.

Excess Profits net income as disclosed by return	$19,036.99
Unallowable deductions and additional income:	
(a) Increase in normal tax net income	25,665.73
(b) Operating loss adjustment	1.54
Total	$44,704.26
Nontaxable income and additional deductions:	
(c) Increase in income and defense taxes	7,708.93
Excess profits net income adjusted	$36,995.33

Explanation of Adjustments.

(a) It is determined under the provisions of section 711(a) of the Internal Revenue Code that excess profits net income should be adjusted by the increase in normal tax net income shown by this statement.

Normal tax net income as corrected	$45,221.14
Normal tax net income per return	19,555.41
Increase	$25,665.73

(b) It is determined under the provisions of section 711(a)(2)(L) of the Internal Revenue Code that income should be adjusted for a dividends received credit.

(c) It is determined under the provisions of section 711(a) of the Internal Revenue Code that income should be decreased by the increase in income and defense taxes shown by this statement.

Excess Profits Credit Based on Invested Capital.

Invested Capital.

Taxable Year ended December 31, 1940.

	Per Return	Adjustment Decrease	Corrected
Equity invested capital at beginning of taxable year	$414,023.16	(a) $24,645.76	$389,377.40
Average additions during year	None		None
Total	$414,023.16		$389,377.40
Average reductions during year	None		None
Average equity invested capital	414,023.16		389.377.40
Average borrowed invested capital	94,249.55	(b) 21,052.83	73,196.72
Average invested capital	508,272.71		462,574.12
Reduction on account of inadmissible assets	None		None
Invested capital	$508,272.71		$462,574.12
Portion of invested capital and applicable credit	$462,574.12	8%	$ 37,005.93

Explanation of Adjustments.

(a) It is determined under the provisions of section 718 of the Internal Revenue Code that equity invested capital should be adjusted by the decrease in accumulated earnings and profits:

Accumulated earnings and profits per return ..	$170,223.16
Accumulated earnings and profits as corrected	145,577.40
Decrease	$ 24,645.76

(b) It is determined that average borrowed invested capital as provided by section 719(b) of the Internal Revenue Code should be decreased by the amount of $21,052.83.

Excess-Profits Tax Computation.

Taxable Year ended December 31, 1940.

Excess profits net income	$36,995.93	
Less: Specific exemption	$ 5,000.00	
Excess profits credit	37,005.93	42,005.93
Adjusted excess profits net income ..		None
Correct excess profits tax liability		None
Previous assessment: Original list, Account No. 801655		None
Deficiency (or overassessment) in excess profits tax		None
Excess profits credit carry-over		None

Excess profits credit carry-over is eliminated after adding Federal income tax of $10,853.07 as provided under Revenue Act of 1941.

Adjustments to Net Income.

Taxable Year ended December 31, 1941.

Net income as disclosed by return	$41,586.85
Unallowable deductions and additional income:	
(a) Capital expenditures	25,000.00
(b) Depreciation	5,633.33
(c) Amortization of reorganization expense	531.39
(d) Capital stock tax	1,200.00
(e) Grenada Hosiery Mills	6,329.43
Net income adjusted	$80,281.00

Explanations of Adjustments.

(a) It is determined that the amount of $25,000.00, representing the cost of additions to buildings and air conditioning constitutes a capital expenditure which is not allowable under section 24(a)(2) of the Internal Revenue Code.

(b) It is determined that the deduction of $16,388.98 claimed on your return for depreciation under the provisions of section 23(l) of the Internal Revenue Code is overstated by the amount of $5,633.33.

(c) It is determined that the deduction of $531.39 claimed by you for amortization of reorganization expense is not allowable under the provisions of section 23(a) or any other section of the Internal Revenue Code.

(d) It is determined that the deduction of $1,575.00 claimed by you for capital stock tax under the provisions of section 23(c) of the Internal Revenue Code is overstated

by the amount of $1,200.00 as provided by section 43 of the Internal Revenue Code.

(e) Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Grenada Hosiery Mills", a purported partnership, have been allocated to you and included in your net income for the taxable year 1941 in the amount of $6,329.43.

In the alternative it is held that said purported partnership is without substance and the said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

Computation of Tax.

Taxable Year ended December 31, 1941.

Declared Value Excess-Profits Tax Computation.

Net income for declared value excess-profits tax computation	$ 80,281.00
Less: 10 percent of $1,000,000.00 value of capital stock as declared or as adjusted for the year ended June 30, 1941	100,000.00
Net income subject to declared value excess-profits tax	None
Total declared value excess-profits tax	None
Declared value excess-profits tax assessed: Original List, Acct. No. 411724	None
Deficiency—Overassessment of declared value excess-profits tax	None

Income Tax Computation.

Net income for declared value excess-profits tax computation			$ 80,281.00
Less: Declared value excess-profits tax			None
Less: Net income for capital stock tax purposes			$ 80,281.00
Less: Excess profits tax			14,467.34
Net income (for surtax computation)			$ 65,813.66
Normal-tax net income and surtax net income			$ 65,813.66
Normal tax (24 percent of normal-tax net income)			$ 15,795.28
	Portion of surtax net income	Rate	Amount of tax
Portion of surtax net income (not in excess of $25,000); and tax	$25,000.00	6%	$ 1,500.00
Portion of surtax net income (in excess of $25,000); and tax	40,813.66	7%	2,856.96
Total surtax			$ 4,356.96
Total normal tax and surtax			20,152.24
Total normal tax and surtax assessed: Original list, Account No. 411724			12,641.92
Deficiency			$ 7,510.32

Adjustments to Excess-Profits Net Income.

Taxable Year ended December 31, 1941.

Invested Capital Method.

Excess Profits net income as disclosed by return	$42,818.83
Unallowable deductions and additional income:	
(a) Net increase in normal tax net income ...	38,694.15
Excess profits net income adjusted	$81,512.98

Explanations of Adjustments.

(a) It is determined under the provisions of section 711(a) of the Internal Revenue Code that excess profits net income should be adjusted by the increase in normal tax net income shown by this statement.

Normal tax net income as corrected	$80,281.00
Normal tax net income per return	41,586.85
Increase	$38,694.15

Excess Profits Credit Based on Invested Capital.
Taxable Year ended December 31, 1941.

Invested Capital.

	Per Return	Adjustments Increase	Adjustments Decrease	Corrected
Equity invested capital at beginning of taxable year	$471,784.03		(a) 1,097.25	$470,686.78
Average additions during year	None			None
Total	$471,784.03			$470,686.78
Average reductions during year	10,737.53			10,737.53
Average equity invested capital	$461,046.50			$459,949.25
Average borrowed invested capital	18,363.02	(b) 494.52		18,857.54
Average invested capital	490,147.05		(c) 11,340.26	478,806.79
Reduction on account of inadmissible assets	6,126.84	(d) 377.81		5,749.03
Invested capital	$484,020.21	$872.33	$11,834.78	$473,057.76

Excess Profits Credit.

Portion of invested capital and applicable credit	$473,057.76	8%	$37,844.62

Explanation of Adjustments.

(a) It is determined under the provisions of section 718 of the Internal Revenue Code that equity invested capital should be adjusted by the decrease in accumulated earnings and profits:

Accumulated earnings and profits per return	$225,984.03
Accumulated earnings and profits as corrected	224,886.78
Decrease	$ 1,097.25

(b) It is determined that average borrowed invested capital as provided by section 719(b) of the Internal Revenue Code should be increased by the amount of $494.52.

(c) To correct error of $10,737.53 in addition on return of average equity invested capital and average borrowed invested capital.

(d) It is determined that the reduction on account of inadmissible assets as provided by section 720 of the Internal Revenue Code should be adjusted by the amount of $377.81.

Excess Profits Tax Computation.

Taxable Year ended December 31, 1941.

Excess profits net income	$81,512.98		
Less:			
Specific exemption	$5,000.00		
Excess-profits credit	37,844.62	42,844.62	
Adjusted excess profits net income		$38,668.36	
Portion $0 to $20,000.00		20,000.00 35%	$ 7,000.00
Portion $20,000 to $50,000		18,668.36 40%	7,467.34
Excess profits tax			$14,467.34
Correct excess profits tax liability			$14,467.34
Previous assessment: Original list, Acct. No. 801475			None
Deficiency in excess profits tax			$14,467.34

Adjustments to Net Income.

Taxable Year January 1, 1942 to December 26, 1942.

Net income as disclosed by return	$27,717.13
Unallowable deductions and additional income:	
(a) Capital expenditures	4,505.78
(b) Depreciation	3,422.33
(c) H. V. Kobin, salary	2,946.00
(d) Grenada Hosiery Mills	4,581.77
(e) Abar Process Company	12,335.43
Total	$55,508.44

Nontaxable income and additional deductions:		
(f) Capital stock tax	$ 750.00	
(g) Sale of capital asset	3,076.95	3,826.95
Net income adjusted		$51,681.49

Explanations of Adjustments.

(a) It is determined that the amount of $4,505.78, representing the cost of improvements and light fixtures, constitutes a capital expenditure which is not allowable under section 24(a)(2) of the Internal Revenue Code.

(b) It is determined that the deduction of $17,816.63 claimed on your return for depreciation under the provisions of section 23(l) of the Internal Revenue Code is overstated by the amount of $3,422.33.

(c) It is determined that the deduction of $22,450.00 claimed for officers' salary to H. V. Kobin, Vice-President, under the provisions of section 23(a) of the Internal Revenue Code is excessive by the amount of $2,946.00.

(d) Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Grenada Hosiery Mills", a purported partnership, have been allocated to you and included in your net income for the taxable year 1942 in the amount of $4,581.77.

In the alternative it is held that said purported partnership is without substance and the said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

(e) Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Abar Process Company", a purported partnership, have been allocated to you and included in your net income for the taxable year 1942 in the amount of $12,335.43.

In the alternative it is held that said purported partnership is without substance and that said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

(f) It is determined that a deduction of $750.00 is allowable under the provisions of section 23(c) and section 43 of the Internal Revenue Code for accrued capital stock tax.

(g) It is determined that the capital gain of $3,476.95, reported by you under the provisions of section 117 and section 22(a) of the Internal Revenue Code for the sale of a residence is overstated by the amount of $3,076.95 due to the disallowance of depreciation claimed in 1941 and 1942.

Computation of Tax.

Taxable Year January 1, 1942 to December 26, 1942.

Declared Value Excess-Profits Tax Computation.

Net income for declared value excess-profits tax computation $51,681.49

Less: 10 percent of $300,000.00 value of capital stock as declared for the year ended June 30, 1942	$30,000.00	
85 percent of dividends received $10.25	8.71	30,008.71
Net income subject to declared value excess-profits tax		$21,672.78

Portion	Amount	Rate	Tax
5 per cent of declared value of capital stock	$15,000.00	6.6%	$990.00
Balance	6,672.78	13.2%	880.81

Total declared value excess-profits tax	$ 1,870.81
Declared value excess-profits tax previously assessed: July 1943 list, Account No. 410165	None
Deficiency—of declared value excess-profits tax	$ 1,870.81

Income Tax Computation.

Net income for declared value excess-profits tax computation		51,681.49
Less: Declared value excess-profits tax		1,870.81
Adjusted net income		$49,810.68
Less:		
Income subject to excess-profits tax	$2,944.71	
Dividends received credit	8.71	2,953.42
Normal-tax net income and surtax net income		$46,857.26

	Portion	Rate	Amount of Tax
Portion of normal-tax net income (not in excess of $5,000); and tax	$ 5,000.00	15%	$ 750.00
Portion of normal-tax net income (in excess of $5,000 and not in excess of $20,000); and tax	15,000.00	17%	2,550.00
Portion of normal-tax net income (in excess of $20,000 and not in excess of $25,000); and tax	5,000.00	19%	950.00
Portion of normal-tax net income (in excess of $25,000); and tax	21,857.26	31%	6,775.75
Total normal tax			$11,025.75
Portion of surtax net income (not in excess of $25,000); and tax	$25,000.00	10%	$ 2,500.00
Portion of surtax net income (in excess of $25,000 and not in excess of $50,000); and tax	21,857.26	22%	4,808.60
Total surtax			$ 7,308.60
Total normal tax and surtax			18,334.35
Alternative tax			17,883.03
Tax liability			$17,883.03
Income tax assessed: July 1943 list, Account No. 410165			7,347.89
Deficiency of income tax			$10,535.14

Computation of Alternative Tax

Taxable year January 1, 1942 to December 26, 1942

Net income			$49,810.68
Less: Net long-term capital gain			1,611.83
Net income reduced by net long-term capital gain			$48,198.85
Less: Income subject to excess-profits tax	$2,944.71		
Dividends received credit	8.71		2,953.42
Balance subject to normal tax and surtax			$45,245.43
Portion of normal tax not in excess of $5,000 at 15%			750.00
Portion of normal tax	$15,000	at 17%	2,550.00
Portion of normal tax	5,000	at 19%	950.00
Portion of normal tax	20,245.43	at 31%	6,276.08
Total normal tax			$10,526.08
Portion of surtax net income	25,000.00	at 10%	2,500.00
Portion of surtax net income	20,245.43	at 22%	4,453.99
Total surtax			$ 6,953.99
Bartial tax			17,480.07
25% of $1,611.83			402.96
Total alternative tax			$17,883.03

Adjustments to Excess Profits Net Income

Taxable Year January 1, 1942 to December 26, 1942

Invested Capital Method

Excess profits net income as disclosed by return	$23,018.10
Unallowable deductions and additional income:	
(a) Net increase in normal tax net income	$22,093.55
(b) Sale of capital assets	3,076.95
Excess-profits net income adjusted	$48,188.60

Explanations of Adjustments

(a) It is determined under the provisions of section 711(a) of the Internal Revenue Code that excess profits net income should be adjusted by the increase in normal tax net income shown by this statement.

Normal tax net income as corrected	$49,810.68
Normal tax net income per return	27,717.13
Increase	$22,093.55

(b) It is determined under the provisions of section 711(a)(2)(D) that excess profits net income should be adjusted by the reduction in gain from sale of capital asset shown by this statement.

Excess Profits Credit Based on Invested Capital.

Taxable Year January 1, 1942 to December 26, 1942.

Invested Capital.

		Adjustments		
	Per Return	Increase	Decrease	Corrected
Equity invested capital at beginning of taxable year	$497,677.39	(a) 11,893.15		$509,570.54
Average additions during year	None			
Total	$497,677.39			$509,570.54
Average reductions during year				
Average equity invested capital	497,677.39			509,570.54
Average borrowed invested capital	108,823.81		(b) 108,823.81	None
Average invested capital	606,501.20			509,570.54
Reduction on account of inadmissible assets	$ 8,187.77	(c) 1,665.88		$ 6,521.89
Invested capital	$598,313.43	13,559.03	108,823.81	503,048.65

Excess Profits Credit

Portion of invested capital and applicable credit ..	$503,048.65	8%	40,243.89

Explanation of Adjustments

Taxable Year January 1, 1942 to December 26, 1942

(a) It is determined under the provisions of section 718 of the Internal Revenue Code that equity invested capital should be adjusted by the increase in accumulated earnings and profits:

Accumulated earnings and profits per return	$273,177.39
Accumulated earnings and profits as corrected	285,070.54
Increase	$ 11,893.15

(b) It is determined that average borrowed invested capital reported on your return under the provisions of section 719 of the Internal Revenue Code should be eliminated.

(c) It is determined that the reduction on account of inadmissible assets as provided by section 720 of the Internal Revenue Code should be adjusted by the amount of $1,665.88.

Excess Profits Tax Computation

Taxable Year January 1, 1942 to December 26, 1942

Excess profits net income		$48,188.60
Less: Specific exemption	$ 5,000.00	

Excess profits credit	40,243.89	45,243.89
Adjusted excess profits net income		$ 2,944.71
90 per cent of $2,944.71		2,650.24
Surtax net income (computed without regard to the credit provided by Section 26(e)		49,801.97
80 percent of $49,801.97		39,841.58
Income tax (other than section 102)		17,883.03
Excess		21,958.55
Lesser amount		2,650.24
Correct excess profits tax liability		$ 2,650.24
Previous assessment: May 1943, Account No. 276902		None
Deficiency in excess profits tax		$ 2,650.24

Post War Refund of Excess Profits tax and Credit for Debt Retirement

Balance of excess profits tax		$ 2,650.24
Credit allowable under sections 780 and 781		265.02
Net reduction in indebtedness under section 783	None	
Credit for debt retirement under section 783		None
Net post-war refund		$ 265.02

Ajudstments to Net Income

Taxable Year December 27, 1942 to December 31, 1943

Net income as disclosed by return		$53,778.52
Unallowable deductions and additional income:		
(a) Depreciation		3,501.29
(b) H. V. Kobin salary		5,976.81
(c) Grenada Hosiery Mills		5,394.33
(d) Abar Process Company		16,071.71
Total		$84,722.66
Nontaxable income and additional deductions:		
(e) Capital stock tax	$125.00	
(f) Contributions	789.06	914.06
Net income adjusted		$83,808.60

Explanations of Adjustments

(a) It is determined that the deduction of $18,591.11 claimed on your return for depreciation under the provisions of section 23(1) of the Internal Revenue Code is overstated by the amount of $3,501.29.

(b) It is determined that the deduction of $25,480.81 claimed for officers salary to H. V. Kobin, Vice-President, under the provisions of section 23(a) of the Internal Revenue Code is excessive by the amount of $5,976.81.

(c) Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Grenada Hosiery Mills," a purported part-

nership, have been allocated to you and included in your net income for the taxable year 1943 in the amount of $5,394.33.

In the alternative it is held that said purported partnership is without substance and the said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

(d) Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Abar Process Company", a purported partnership, have been allocated to you and included in your net income for the taxable year 1943 in the amount of $16,071.71.

In the alternative it is held that said purported partnership is without substance and that said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

(e) It is determined that the deduction of $1,125.00 claimed by you for capital stock tax under the provisions of section 23(c) of the Internal Revenue Code is understated by the amount of $125.00 as provided by section 43 of the Internal Revenue Code.

(f) It is determined that the deduction of $2,830.44 claimed by you for contributions under the provisions of section 23(q) of the Internal Revenue Code is understated by the amount of $789.06.

Computation of Tax

Taxable Year December 27, 1942 to December 31, 1943

Declared Value Excess-Profits Tax Computation

Net income for declared value excess profits tax computation		$83,808.60
Less: 10 percent of $600,000.00 value of capital stock tax as declared for the year ended June 30, 1943	$60,000.00	
85 percent of dividends received	10.46	60,010.46
Net income subject to declared value excess-profits tax		$23,798.14

Portion	Amount	Rate	Tax
5 percent of declared value of capital stock (but not more than $23,798.14)	$23,798.14	6.6%	$1,570.68
Total declared value excess-profits tax			$1,570.68
Declared value excess-profits previously assessed: July 1944 list, Account No. 410008			None
Deficiency of declared value excess-profits tax			$1,570.68

Income Tax Computation

Net income for declared value excess-profits tax computation	$83,808.60
Less: Declared value excess-profits tax	1,570.68

Net income			$82,237.92
Less: Income subject to excess profits tax	$38,316.75		
Dividends received credit	10.46		38,327.21
Normal-tax net income and surtax net income			$43,910.71
	Portion	Rate	Amount of Tax
Portion of normal-tax net income (not in excess of $5,000); and tax	$ 5,000.00	15%	$ 750.00
Portion of normal-tax net income (in excess of $5,000 and not in excess of $20,000); and tax	15,000.00	17%	2,550.00
Portion of normal-tax net income (in excess of $20,000 and not in excess of $25,000); and tax	5,000.00	19%	950.00
Portion of normal-tax net income (in excess of $25,000); and tax	18,910.71	31%	5,862.32
Total normal tax			$10,112.32
Portion of surtax net income (not in excess of $25,000); and tax	$25,000.00	10%	$ 2,500.00
Portion of surtax net income (in excess of $25,000 and not in excess of $50,000); and tax	18,910.71	22%	4,160.36
Total surtax			$ 6.660.36
Total normal tax and surtax			$16,772.68

Income tax assessed:	
July 1944 list, Account No. 410008	21,507.22
Overassessment of income tax	$ 4,734.54

Adjustments to Excess-Profits Net Income

Taxable Year December 27, 1942 to December 31, 1943

Invested Capital Method

Excess profits net income as disclosed by return	$53,766.22
Unallowable deductions and additional income:	
(a) Net increase in normal tax net income ..	28,459.40
Excess profits net income adjusted	$82,225.62

Explanations of Adjustments

(a) It is determined under the provisions of section 711(a) of the Internal Revenue Code that excess profits net income should be adjusted by the increase in normal tax net income shown by this statement.

Normal tax net income as corrected	$82,237.92
Normal tax net income per return	53,778.52
Increase	$28,459.40

Excess Profits Credit Based on Invested Capital.

Invested Capital.

	Per Return	Adjustments Increase	Adjustments Decrease	Corrected
Equity invested capital at beginning of taxable year	$490,663.21 (a)	464.44		$491,127.65
Average additions during year	None			None
Total	$490,663.21			$491,127.65
Average reductions during year	None			None
Average equity invested capital	$490,663.21			$491,127.65
Average borrowed invested capital	129,430.67		(b) 129,378.39	52.28
Average invested capital	620,093.88			491,179.93
Reduction on account of inadmissible assets	7,069.07 (c)	2,249.96		4,819 11
Invested capital	$613,024.81	$2,714.40	129,378.39	$486,360.82

Excess-Profits Credit

Portion of invested capital and applicable credit	$486,360.82	8%	$38,908.87

Explanation of Adjustments

(a) It is determined under the provisions of section 718 of the Internal Revenue Code that equity invested capital should be adjusted by the increase in accumulated earnings and profits:

Accumulated earnings and profits as corrected	$266,627.65
Accumulated earnings and profits per return	266,163.21
Increase	$ 464.44

(b) It is determined that average borrowed invested capital reported on your return under the provisions of section 719 of the Internal Revenue Code should be decreased by the amount of $129,378.39.

(c) It is determined that the reduction on account of inadmissible assets as provided by section 720 of the Internal Revenue Code should be adjusted by the amount of $2,249.96.

Excess profits tax computation

Taxable Year December 27, 1942 to December 31, 1943

Excess profits net income		$82,225.62
Less: Specific exemption	$ 5,000.00	
Excess profits credit	38,908.87	43,908.87

Adjusted excess profits net income	38,316.75
90 per cent of $38,316.75	34,485.08
Surtax net income (computed without regard to the credit provided by Section 26(e)	82,227.46
80 percent of $82,227.46	65,781.97
Income tax (other than section 102)	16,772.68
Excess	49,009.29
Lesser amount	34,485.08
Correct excess profits tax liability	34,485.08
Previous assessment: July 1944, Account No. 801503	None
Deficiency in excess profits tax	34,485.08

Post War Refund of Excess Profits Tax and Credit for Debt Retirement

Taxable Year December 27, 1942 to December 31, 1943

Balance of excess profits tax		$34,485.08
Credit allowable under sections 780 and 781		3,448.51
Net reduction in indebtedness under section 783	None	
Credit for debt retirement under Section 783		None
Net post war refund		$ 3,448.51

ANSWER.

Received Jan. 3, 1950.

Filed Jan. 3, 1950.

The Tax Court of the United States

National Hosiery Mills, Inc., Petitioner,
v. Docket No. 24640.
Commissioner of Internal Revenue, Respondent.

Comes Now the Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits, alleges, avers and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the taxable years 1940, 1941, 1942 and 1943, declared value excess-profits taxes for the taxable years 1941, 1942 and 1943, excess profits taxes for the taxable years 1941 and 1942, and excess profits tax and penalty thereon for the taxable year 1943. Denies the remaining allegations contained in paragraph 3.

4(a) to (e), inclusive. Denies that the respondent erred as alleged in subparagraphs (a) to (e), inclusive, of paragraph 4 of the petition.

4(f). Avers that by virtue of its order dated November 9, 1949, granting respondent's motion to dismiss the in-

stant petition in so far as it related to relief under section 722 of the Internal Revenue Code, the Court has stricken the purported assignment of error contained in subparagraph (f) of paragraph 4 of the petition.

5(a) and (b). Denies the allegations contained in subparagraphs (a) and (b) of paragraph 5 of the petition.

5(c). Denies the allegations contained in subparagraph (c) of paragraph 5 of the petition, except it is admitted that the words enclosed by quotation marks are contained in the statement attached to the notice of deficiency mailed on June 2, 1949.

5(d). Denies the allegations contained in subparagraph (d) of paragraph 5 of the petition.

5(e) and (f). Avers that the allegations contained in subparagraphs (e) and (f) of paragraph 5 of the petition consist of argumentative and immaterial matter and conclusions which should be stricken or disregarded.

Further answering said subparagraphs, respondent denies the material allegations of fact, if any, contained therein.

5(g). Denies the allegations contained in subparagraph (g) of paragraph 5 of the petition.

5(h). Denies the allegations contained in subparagarph (h) of paragraph 5 of the petition, except it is admitted that the words enclosed by quotation marks are contained in the statement attached to the notice of deficiency mailed on June 2, 1949.

5(i). Denies the allegations contained in subparagraph (i) of paragraph 5 of the petition.

5(j). Denies the allegations contained in the first three sentences of subparagraph (j) of paragraph 5 of the petition.

Avers that the remainder of said subparagraph consists of argumentative and immaterial matter and conclusions which should be stricken or disregarded. Further answering the remainder of said subparagraph, respondent denies the material allegations of fact, if any, contained therein.

5(k). Denies the allegations contained in subparagarph (k) of paragraph 5 of the petition.

5(l) and (m). Avers that by virtue of its order dated November 9, 1949, granting respondent's motion to dismiss the instant petition in so far as it related to relief under section 722 of the Internal Revenue Code, the Court has stricken the allegations contained in subparagraphs (l) and (m) of paragraph 5 of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified, or denied.

Wherefore, it is prayed that the petitioner's appeal be denied.

CHARLES OLIPHANT, LMP.
(Charles Oliphant),
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:
PHILIP M. CLARK,
Division Counsel.
LESTER M. PONDER,
Special Attorney,
Bureau of Internal Revenue.

PETITION.

Filed Aug. 18, 1949.

The Tax Court of the United States

Grenada Industries, Inc., Petitioner,
vs. Docket No. 24571.
Commissioner of Internal Revenue, Respondent.

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated June 2, 1949, and as a basis of its proceeding alleges as follows:

1. Petitioner is a corporation organized under the laws of the State of Mississippi with its principal office and place of business at Grenada, Mississippi. The returns of petitioner for the periods here involved were filed with the Collector for the District of Mississippi.

2. The notice of deficiency, a copy of which is attached hereto and marked Exhibit "A", was mailed to petitioner on the 2nd day of June, 1949.

3. The taxes in controversy are income, declared value excess profits tax and excess profits tax for the fiscal periods ending March 31, 1941-2-3 and 4 in the amounts of (a) income taxes, in the aggregate amount of $53,-783.19; (b) declared value excess profits tax, in the amount of $10,265.16; and (c) excess profits tax, in the aggregate amount of $146,318.96. The whole amount of such taxes is in dispute.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The respondent has erroneously, arbitrarily and capriciously allocated and included as income of petitioner an item of net income of Grenada Hosiery Mills (a separate organization) the amount of $62,068.57, for the period 3/31/41; the amount of $29,164.11, for the period 3/31/42; the amount of $30,189.53, for the period 3/31/43; and the amount of $45,893.73 for the period 3/31/44.

(b) The respondent has erroneously, arbitrarily and capriciously allocated and included as income of petitioner an item of net income of Abar Process Company (a separate organization) the amount of $116.14 for the period 3/31/42; the amount of $338.85 for the period 3/31/43; and the amount of $547.70 for the period 3/31/44.

(c) The respondent errs in his proposal to disallow claims for refund of excess profits tax paid for the periods involved in the aggregate amount of $73,111.00 so that petitioner might avail itself of the provisions of Section 722(a), (b)(4) and (5) of the Internal Revenue Code for relief from the excessive and discriminatory nature of its excess profits tax liability when computed without the benefit of Section 722 of the Code.

5. The facts upon which petitioner relies as a basis of this proceeding are as follows:

(a) In the explanatory statement accompanying the deficiency notice of June 2, 1949, respondent makes the following arbitrary and capricious statement of the grounds for invoking the provisions of Section 45 of the Internal Revenue Code with respect of "Grenada Hosiery

Mills" that he purports to allocate as taxable income of petitioner, viz:

"Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to 'Grenada Hosiery Mills', a purported partnership have been allocated to you and included in your net income for the taxable years and in the amounts set forth below, to-wit:

Fiscal year ended March 31, 1941	$62,068.57
Fiscal year ended March 31, 1942	29,164.11
Fiscal year ended March 31, 1943	30,189.53
Fiscal year ended March 31, 1944	45,893.73

In the alternative it is held that said purported partnership is without substance and that said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code."

(b) The Grenada Hosiery Mills is a partnership organization and is composed of members in the proportion of 65% of its ownership who are not stockholders and/or owners of the business of Grenada Industries, Inc. The Grenada Hosiery Mills operates independently with respect to the business it transacts and the only relation it has with petitioner is evidenced by an agreement to take the products of petitioner at the manufacturing stage thereof where equipment of petitioner is limited and processes the material into finished merchandise for sale.

(c) During the period in qeustion petitioner was the manufacturer of hosiery in the grey. It was not equipped to have the hosiery thus manufactured finished for sale

to the trade after dyed, graded and sized; petitioner being an organization that employed non-union labor for the manufacture of hosiery in the grey could not employ the services of another mill employing union labor to finish the hosiery for sale. The price which the Grenada Hosiery Mills paid petitioner for its hosiery manufactured in the grey was at the fair market price of such merchandise, and the formula for adjusting the price—in the event of dispute—was upon a fair and reasonable basis. There was no provision in the agreement between the parties for the allocation of expenses incident to the manufacture, finishing and sale of said hosiery, and the proposal of respondent to allocate to petitioner approximately 95% of the operating profits that Grenada Hosiery Mills realized in its business activity is arbitrary and capricious. In computing the tax liability of the members of the partnership of Grenada Hosiery Mills, petitioner is advised that the respondent limits distributable profits to 10% of capital contributed by members of the partnership. This is further evidence of the arbitrary conduct of respondent; and is in conflict with his proposal that the partnership is without substance.

(d) The arbitrary and capricious character of the conduct of respondent in making the allocation proposed is clearly demonstrated by the alternative aspect of his proposal whereby he proposes to make the determination that Grenada Hosiery Mills is "without substance" and the net income earned in connection with the business it transacted is taxable income of petitioner within the meaning of Section 22(a) of the Internal Revenue Code. The proposals of respondent are self-destructive; and do not evidence the exercise of a sound discretion required by Section 45 of the Code.

(e) Petitioner avers that at the time it entered into business relations with Grenada Hosiery Mills it took the precaution of examining into its status as a business organization and the qualifications of its personnel to conduct the business undertaken under agreements with petitioner; and petitioner avers that the determination of respondent that the Grenada Hosiery Mills is a "purported organization without substance" is not true. The employees of Grenada Hosiery Mills are not mutual or dual employees of petitioner; and the businesses of the two organizations are conducted more than one thousand miles apart from each other.

(f) In the explanatory statement accompanying the deficiency notice of June 2, 1949 respondent makes the following statement of the grounds for invoking the provisions of Section 45 of the Internal Revenue Code with respect to items of net income of "Abar Process Company" that he purports to allocate as taxable income of petitioner, viz:

"Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to 'Abar Process Company', a purported partnership, have been allocated to you and included in your net income for the taxable years and in the amounts set forth below, to-wit:

Fiscal year ended March 31, 1942	$116.14
Fiscal year ended March 31, 1943	338.85
Fiscal year ended March 31, 1944	547.70

In the alternative it is held that said purported partnership is without substance and that said portions of the income which were attributed to said purported partner-

ship are taxable to you under the provisions of section 22(a) of the Internal Revenue Code."

(g) The Abar Process Company is a partnership composed of persons who are not stockholders and/or owners of the business of petitioner. The Abar Process Company operates inedpendently in the business it transacts; and the only business relation that petitioner has with the Abar Process Company is to sell to it at a fair price waste material from the process of manufacturing hosiery. The Abar Process Company reclaims from such waste material, and waste material of a similar character acquired from sources other than petitioner, yarn of a nature that is of utility in manufacturing hosiery. The petitioner buys from Abar Process Company yarn reclaimed from waste material as aforesaid and pays to it a fair price therefor. Petitioner has no business relation with Abar Process Company except as above stated, and the business of petitioner is in nowise related to the business conducted by the Abar Process Company within the meaning of Section 45 of the Code. In computing the tax liability of members of the partnership of Abar Process Company petitioner is advised that respondent limits distributable profits to 10% of capital contributed by members, yet the position he takes herein is that Abar Process Company is "without substance".

(h) The arbitrary and capricious character of the conduct of respondent in making the allocation of net income of Abar Process Company as proposed is clearly demonstrated by the alternative aspect of his proposal whereby he purports to make a determination that Abar Process Company is "without substance" and that the net income earned in connection with its business is taxable income of petitioner within the mearning of Section 22(a) of the

Code. The facts show clearly that Abar Process Company is an organization capable of transacting a business from which income is derived. The employees of Abar Process Company are not mutual or dual employees of petitioner, and the businesses of the two organizations are conducted more than one thousand miles apart from each other. The Abar Process Company owns and possesses substantial capital and surplus profits.

(i) Petitioner has paid to the Collector of Internal Revenue for the Collecting District of Mississippi the following amounts of excess profits tax proposed against it for the periods aforesaid, to-wit: For the period ending 3/31/41, $9,176.00; for the period ending 3/31/42, $5,662; for the period ending 3/31/43, $34,970; and for the period ending 3/31/44, $23,303. Immediately after the payment of excess profits tax as aforesaid petitioner filed a claim for the refund thereof pursuant to an application for relief under Section 722 of the Internal Revenue Code as provided by Form 991, United States Treasury Department. The application for relief under Section 722 of the Code was supported fully by data; and the grounds of the application were set forth in the leading statement accompanying the application as follows, viz:

"The above-named taxpayer hereby makes application for relief from the burden of excessive and discriminatory tax that results for the taxable years ended March 31, 1941 to March 31, 1944 when the tax for each of said years or accounting periods is computed under Subchapter E, Part I of the Internal Revenue Code without the benefit of Section 722 of said Code.

Application of Section 713:

Section 713(b) of the Code reads as follows:

'(1) Definition—As used in this section the term "base period"—

(A) if the corporation was in existence during the whole of the forty-eight months preceding the beginning of its first taxable year under this subchapter, means the period commencing with the beginning of its first taxable year beginning after December 31, 1935, and ending with the close of its last taxable year beginning before January 1, 1940; and

(B) In the case of a corporation which was in existence during only part of the forty-eight months preceding the beginning of its first taxable year under this subchapter means the forty-eight months preceding the beginning of its first taxable year under this subchapter.'

The taxpayer commenced business in July during the base period year 1937, and is a corporation ordinarily entitled to excess-profits credit—based on income—as provided by Section 713 of the Code; but its average base period income is an inadequate standard of normal earnings that should have been realized.

Invocation of Section 722(b)(4):

'(b) Taxpayers Using Average Earnings Method.—The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer entitled to use the excess-profits credit based on income pursuant to section 713, if its average base period net income is an inadequate standard of normal earnings because—

* * * * * * * *

'(4) The taxpayer, either during or immediately prior to the base period, commenced business or changed the character of the business and the average base period net income does not reflect the normal operation for the entire base period of the business. If the business of the taxpayer did not reach, by the end of the base period, the earning level which it would have reached if the taxpayer had commenced business or made the change in the character of the business two years before it did so, it shall not be deemed to have commenced business or made the change at such earlier time.'

The normal earnings that the taxpayer reasonably expected from the character of business it commenced during the base period year 1937 would have reached a level from which a normal standard of net income could have been realized in the base period, if it had commenced the business two years before it did. The normal earnings of a business in which taxpayer was engaged are adequate or inadequate in proportion to the occurrence of factors which affect production.

Nature of Business:

The business of the taxpayer is the production of 45 and 51 gauge full-fashion ladies hosiery, in the grege*; and when the business was intiated the type of material commonly used for the manufacture of full-fashion ladies hosiery was silk. However, any other type of material that produced hosiery comparable to the grade and quality of 'silk hosiery' was not excluded but during the base period there was an adequate supply of silk thread to supply the demand for 45 and 51 gauge, full-fashion ladies hosiery that taxpayer prepared to produce in the grege.

* Hosiery fully knitted, looped and seamed from raw yarn to a stage ready for the finishing mill operation.

History of Operations:

The business of the taxpayer was commenced on or about July 1st, 1937 by acceptance by a pre-organization committee of the taxpayer of a proposition submitted by the City of Grenada, Mississippi, that it would lease to the taxpayer, when organized, a newly constructed mill-type building for a period of twenty-five years, with an option of renewal for a second period of twenty-five years at the annual rental of $5.00 per annum. The conditions of the proposed lease of the building were that taxpayer (1) pay the taxes assessed upon the leased property (with certain statutory exemptions for a period of five years granted by the City of Grenada); (2) keep the leased property insured, against loss by fire or other casualty; (3) in the event of damage by fire or other casualty covered by the policy, to use the proceeds of insurance for repair; (4) pay all expenses incidental to up-keep and necessary repairs on the property; (5) maintain a payroll of not less than $60,000 per annum; and (6) install knitting machinery of the invoiced cost of not less than $160,000. The premises were to be used for the operation of a knitting mill; and preference in respect to employees was to be given to the residents of the City of Grenada, Mississippi.

When the taxpayer was organized and incorporated on or about November 29, 1937 it ratified and accepted the acts and deeds of its pre-organization committee, aforesaid.

On or about September 1, 1937 the pre-organization committee of the taxpayer commenced the work of putting the leased premises in condition for use as a grege knitting mill operation by the installation of necessary machinery. During the period from about September 1, 1937 to De-

cember 31, 1937 there was paid out by the taxpayer and/or its pre-organization committee the aggregate sum of $22,-847.94 in the preparation of the premises for use as a grege knitting mill; which amount includes expenses incident to the commencement of business by the purchase and installation of machinery and training operators.

For the period of January 1, 1938 to March 31, 1938, there was expended by the taxpayer for machinery installations, and training persons to operate the knitting machines to be installed, the aggregate sum of $40,716.07. There was work in progress in respect to producing grege hosiery, or training machine operators, from the 1st of September, 1937 to February 12, 1938; but during that period no production of grege hosiery suitable for sale, or for finishing processes, was turned out by the taxpayer. The first production of grege hosiery suitable for sale, or for finishing processes, was turned out in small quantities on or about February 12, 1938; and from January 1, 1938 to December 31, 1938, the taxpayer produced, or had in process of production in the grege, full-fashion ladies hosiery in the quantity of approximately 80,000 dozen.

On or about September 1, 1937 the preorganization committee of the taxpayer placed an order with Alfred Hofman, Inc., of West New York, New Jersey, for 20-45 gauge, and for 10-51 gauge, Schubert & Salzer full-fashion hosiery knitting machines at the invoice price of $450,610 (cost of installation $22,740.85) for use by the taxpayer at Grenada, Mississippi, when delivered and installed. Interest in the approximate amount of $44,000 on the deferred purchase price of such machinery was incurred and paid. Such machinery was manufactured in Germany and was guaranteed to be perfect in workmanship and material. The delivery and installation of such machinery

commenced on or about November 1, 1937, and by assurance from the sales agency therefor, aforesaid, were to be installed between the dates of December 6, 1937 to April 16, 1938, and turned over for use and full operation by the taxpayer between the dates of December 13, 1937 and April 23, 1938. The patent condition of such knitting machines appeared first-class; but when use thereof was commenced on the dates scheduled for full use by the taxpayer, the latent condition of the machines proved to be defective both as to workmanship and material.

The machines were of a high speed character, but the taxpayer did not desire to use them at an operating speed in excess of sixty-eight courses per minute for the first four weeks of their use, and after the test period of such speed as the experience of the operators tending them might warrant, up to 80 courses per minute; but because of defects in the knitting machines the attained speed of approximately 68 courses per minute has not been exceeded in actual operation.

There is attached hereto as Exhibit 'A' a schedule showing the expected production capacity of the 30 knitting machines—based upon a 40-hour work week established for the industry; but as explained herein, the normal production capacity of said knitting machines was not realized in the base period because of imperfections that were discovered after operation was begun.

The 30 knitting machines aforesaid were paid for by J. A. and L. L. Goodman, members of the pre-organization committee of the taxpayers; and the title thereto was taken by said two persons in the name of a partnership of Grenada Hosiery Mills (Machinery). The Grenada Hosiery Mills (Machinery) partnership entered into an

agreement with the taxpayer to rent to it the use and hire of said 30 knitting machines at an annual minimum rental equal to 37½¢ per dozen of grege hosiery produced, or a maximum rental equal to depreciation computed on the cost basis of said knitting machines over an estimated useful life of 10 years or at such rate of depreciation as was allowed by the Bureau of Internal Revenue; and that the maximum basis of rental payment at the rate of 10%, or the Bureau rate, of cost per annum would be operative when the rental basis of 37½¢ per dozen of grege hosiery produced exceeds the aggregate amount of annual depreciation allowable at a 10% rate of cost, adjusted to Bureau rate.

The first three full years of operation for the production of full-fashion ladies hosiery in the grege of the business of the taxpayer that was commenced at Grenada, Mississippi, in September, 1937 by the installation of machines to train operators, and the 'shake-down' period from December 6, 1937 to April 25, 1938 to break in the operation of the new machinery installed between the dates of December 6, 1937 and April 16, 1938, was at the rate of 79,035 dozen for a twelve-month period beginning March 1, 1938 and ending March 31, 1939; at the rate of 142,238 dozen for a twelve-month period beginning March 1, 1939 and ending March 31, 1940; and at the rate of 201,361 dozen for a twelve-month period beginning March 1, 1940 and ending March 31, 1941. However, if the foregoing fiscal three year production period be related to actual production in the calendar years 1938, 1939 and 1940, the result is—1938, 53,629; 1939, 135,007; and 1940, 183,332. There were four months in the calendar year 1938 of actual operation that embraced the shake-down period of December 6, 1937 to April 23, 1938; and by application of the 'push-back' rule provided for in Section 722(b)(4)

of the Code, the reconstructed production in the grege of full-fashion ladies hosiery that could have been reasonably expected by the taxpayer under normal conditions would be, viz: Calendar year 1936, 80,000 dozen; calendar year 1937, 135,00 dozen; calendar year 1938, 183,000 dozen; and calendar year 1939, 210,000 dozen.

The latent defects in the knitting machines installed—before corrected by changes and repairs—interfered more definitely with normal production in the first twelve-months period of operation in which the break in and 'shake-down period occurred than later; and for that reason the reconstructed normal production for the base period year 1936, aforesaid, is stated at 80,000 dozen. The machines installed—under the guarantee of perfection in workmanship and material—had a capacity for a normal production in the base period years, as above stated; and since the taxpayer had on hand a sufficient supply of yarn, there is no basis to doubt that the normal production as stated above could not have been realized in the base period years if the taxpayer had commenced business—(as conducted for it by the pre-organization committee)—two years before it did in the month of July, 1937.

Invocation of Section 722(b)(5):

'(5) of any other factor affecting the taxpayer's business which may reasonably be considered as resulting in an inadequate standard of normal earnings during the base period and the application of this section to the taxpayer would not be inconsistent with the principles underlying the provisions of this subsection, and with the conditions and limitations enumerated therein.'

There are other factors— besides the tardy commencement of business in the month of July, 1937, during the base period—which affected the business of the taxpayer during the base period that may reasonably be considered as resulting in an inadequate standard of normal production that would not be inconsistent with the principles underlying the provisions of Section 722 of the Code which provide for the reconstruction of 'average base period net income'. Some of the major factors which affected normal production in the base period—when applied to the principle of constructive earnings—are, viz:

(a) The persons employed to tend and operate the knitting machines installed were not trained and skilled workmen in the hosiery industry; and it required from two to three years to train such employees as efficient operators.

(b) The knitting machines installed were of a single-unit of production in that the foot and leg of the hosiery were knitted as a 'single operation'.

(c) Because of latent defects in the knitting machiens there was an unusual amount of idle time for repairs; and when repairs were made a break-in period of the new parts slowed up the normal speed of the machines; and

(d) The abnormal amount of $79,883.55 expended for repairs and maintenance labor to keep the machines in operation during the base period covered by the calendar years 1938 and 1939 is evidence of the latent defects in machines that were deemed to be perfect when installed. The average cost of repairs and labor was approximately $2,600 for each of the 30 machines installed during the fiscal years March 31, 1931 and March 31, 1940 (nine

months of calendar year 1938, the whole of calendar year 1939, and three months of calendar year 1940), or a ratio of approximately 28% of the wages of the operator in production operations. This would indicate a substantial loss in productive operation time actually experienced during the calendar years 1938 and 1939 of the base period.

The foregoing factors are taken into consideration in the reconstruction of normal production for the base period years 1936, 1937, 1938 and 1939. These are conditions that did prevail, but were normally not to be expected; and should, therefore, be eliminated to such an extent that is deemed fair and reasonable in the reconstruction of base period production.

The post base period tax computed upon net income of the taxpayer for the fiscal years ended March 31, 1941, March 31, 1942, March 31, 1943 and March 31, 1944 is deemed to be excessive and discriminatory because the earnings realized in those years are more or less due to, and are primarily the result of expenditures made in the base period in connection with (a) installation of machinery, (b) break-in operations; (c) shake-down period of operation; (d) training of efficient machine operators; and (e) correcting latent defects in the 30 new single unit machines installed for the production of full-fashion ladies hosiery.

The taxpayer did not have a finishing department for dying, boarding, grading and packing the hosiery produced in the grege; but through an arrangement made with the National Hosiery Mills, Inc., of Indianapolis, Indiana, by a distribution and sales organization acting for the taxpayer, the grege hosiery produced by the taxpayer during the base period was dyed, boarded, graded and

packed for sale to the trade as finished hosiery by the said National Hosiery Mills, Inc.

The taxpayer was—during the base period—essentially and categorically a 'grege hosiery mill', and for the purpose of reconstructing normal production of grege hosiery from which normal earnings could have been realized, the prevailing market price of grege hosiery during the base period years is used. However, the market price of the hosiery when finished, as aforesaid, is also shown in a schedule attached hereto.

Submission of Data for the Reconstruction of Base Period Net Income:

Section 722(a) of the Internal Revenue Code, reads as follows:

'(a) General Rule.—In any case in which the taxpayer establishes that the tax computed under this subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period, the tax shall be determined by using such constructive average base period net income otherwise determined under this subchapter. In determining such constructive average base period net income no regard shall be had to events or conditions affecting the taxpayer, the industry of which it is a member, or taxpayer generally occurring or existing after December 31, 1939, except that, in the cases described in the last sentence of section 722 (b) (4) and in section 722 (c), regard

shall be had to the change in the character of the business under section 722 (b)(4) of the nature of the taxpayer and the character of its business under section 722 (c) to the extent necessary to establish the normal earnings to be used as the constructive average base period net income.'

There is attached hereto and made a part hereof the following schedules and computations, viz:

1. A columnar statement and supporting schedules showing actual operation of the taxpayer for the fiscal years ended March 31, 1939 to March 31, 1942.

2. A columnar statement and supporting schedules showing the manner and method in which the reconstructed operation of the taxpayer for the base period is computed, assuming its output of hosiery were sold in grege stage; and

3. A columnar statement and supporting schedules showing the manner and method in which the reconstructed operation of the taxpayer for the base period is is computed, assuming its output of hosiery were sold in the finished stage.

Explanation of Date Submitted:

In the preparation of the columnar statements of reconstructed operation for the base period (when the operations are confined to the production of grege hosiery), we have drawn from actual experience of costs and operations of the taxpayer during the calendar years 1938 and 1939, covered by the fiscal periods ending March 31, 1939 and March 31, 1940.

In other words, if the operations of the taxpayer as reflected by the schedule of actual operations for the fiscal years March 31, 1939 and March 31, 1940 be confined to the production of grege hosiery at the then prevailing prices as between 45 gauge and 51 gauge in the ratio of 2/3 of gauge 45 produced by 20 knitting machines and 1/3 of gauge 51 produced by 10 knitting machines, the profits experience would be greatly different.

With respect to actual production in the calendar years 1938 and 1939, the number of dozens of hosiery produced in the calendar year 1938 (April 1st to December 31st, 1938), was 53,629 dozen for the calendar year 1938 and 135,007 dozen for the calendar year 1939. The sale of 135,000 dozens hosiery in the grege of all gauges at the average price of $6.50 per dozen would result in gross income of $877,500; and by applying to such production for the calendar year 1939 the normal costs prevailing to complete the grege manufacture operations, the resultant level of gross profits would be $190,276.13, or a net profit from actual experience of a grege mill of $170,194.51. In other words, if the 1939 calendar year production of grege hosiery by the taxpayer had been sold as such at the prevailing market of $6.50, there should be eliminated the cost item of $39,012 designated as 'purchased processing' for the fiscal year ended March 31, 1939 and $90,381 designated as 'purchased processing' for the fiscal year ended March 31, 1940. That is, the actual 'grege' production costs covered by the fiscal accounting years March 31, 1939 and March 31, 1940 are annualized at the sum of 1/4 of such cost of the fiscal year ended March 31, 1939, and 3/4 of such cost for the fiscal year ended March 31, 1940—the result is an actual cost of sales for the calendar year 1939 of $687,223.87. The item of $687,-223.87, 1939 actual cost of sales calculated as aforesaid

does not include any part of 'finished costs' incurred by the items of $39,012 and $90,381 designated 'purchased processing' but such costs do include the 'questionable item' of $34,027 'repairs and maintenance', and $8,115 'reserve for overhauling' for the fiscal year ended March 31, 1939 and the same type of items of $45,862 and $16,076 for the fiscal year March 30, 1940. The 'reserve for overhauling' items is not true cost, and should be eliminated.

The computed net income of $170,194.51 from the calendar year production of grege hosiery does not reflect a deduction of $19,109 for actual cost for fiscal year March 31, 1939, and actual costs for fiscal year March 31, 1940, designated 'packing and shipping expense' of the finished hosiery. Otherwise, the actual expense or cost is used in the computation of grege production cost and resultant constructed profit.

The schedules and supporting data submitted with this claim for relief, which reflect a calculation of the reconstructed base period average normal net income, are supported by substantial evidence; and it is believed that such schedules and data fully establish normal earnings that reasonably could be expected in the grege hosiery industry during the base period."

(j) The respondent, acting through the Excess Profits Tax Council of his office, has taken no specific action on petitioner's application for relief; but in the statement accompanying the deficiency notice of June 2, 1949 the following recommendation is made, viz:

"If a petition to the Tax Court of the United States is filed against the deficiency proposed herein, the issues set forth in your claims for refund should be made a part

of the petition to be considered by the Tax Court in any redetermination of your tax liability. If a petition is not filed, the claims for refund will be disallowed and official notice will be issued by registered mail in accordance with section 3772 of the Internal Revenue Code."

(k) It is not the purpose of petitioner to abandon its application for relief under the provisions of Section 722 of the Code and upon the grounds stated in its claims for such relief, and if a review by this Honorable Court of said application for relief as filed and perfected in respondent's office is premature because of the failure of respondent to make a decision thereon sooner than the date of his deficiency notice herein, petitioner requests that it be allowed the privilege of filing an amendment to this petition so that final action taken by respondent on petitioner's application for relief may be reviewed by this Honorable Court as provided by law.

Wherefore, petitioner prays:

1. That the Court hear this appeal on the issues, matters and questions presented and/or necessarily involved with respect to the deficiencies in tax claimed;

2. That the Court make findings of fact and decision on each issue presented in the light of the proof submitted;

3. That the determination of respondent be held to be erroneous, arbitrary and capricious in so far as he undertakes to make an allocation under the provisions of Section 45 of the Code; and

4. That relief to which petitioner is entitled to pursuant to its application therefor under the provisions of Section 722 of the Code be granted.

5. That petitioner be given such other further and general relief that it is entitled to in the premises.

ROBERT A. LITTLETON,
(Robert A. Littleton),
Attorney for Petitioner.

1021 Tower Building,
Washington, D. C.

Of Counsel:
ARTHUR L. GILLIOM,
Suite 1342, Consolidated Building,
Indianapolis 4, Indiana.

State of Mississippi,
Grenada County. ss.

John C. Lake makes oath in due form of law and says that he is President of petitioner named herein; that he has read over the foregoing petition; is familiar with the facts stated therein, and that they are true to the best of his knowledge, information and belief.

JOHN C. LAKE,
(John C. Lake).

Subscribed and sworn to before me this the 15 day of August, 1949.

DICK JONES YATES,
(Seal) Notary Public.

My Commission Expires July 16, 1951.

Treasury Department,
Internal Revenue Service,
Room 600, 309 W. Washington Street,
Indianapolis 4, Ind.

Indianapolis Division. June 2, 1949.

Grenada Industries, Inc.,
C/o Mr. Charles E. Stevens,
502 North Davidson Street,
Indianapolis, Indiana.

Gentlemen:

You are advised that the determination of your income tax liability for the taxable years ended March 31, 1941, 1942, 1943 and 1944, discloses a deficiency of $53,783.19, and that the determination of your declared value excess-profits tax liability for the taxable year ended March 31, 1941, discloses a deficiency of $10,265.16, and that the determination of your excess profits tax liability for the taxable years ended March 31, 1941, 1942, 1943 and 1944, discloses a deficiency of $146,318.96, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Indianapolis, Indiana. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,
GEO. J. SCHOENEMAN,
By (Signed) ROBERT E. WILSON,
Internal Revenue Agent in Charge.

Enclosures:
Statement.
Form of Waiver (874).
LED:me.

Statement.

IT:C:LED.

Grenada Industries, Inc.,
C/o Mr. Charles E. Stevens,
502 North Davidson Street,
Indianapolis, Indiana.

Tax Liability for the Taxable Year.

April 1, 1940 to March 31, 1941 and Taxable Years Ended March 31, 1942, March 31, 1943 and March 31, 1944.

Income Tax.

Years	Liability	Assessed	Deficiency
4- 1-40 to 3-31-41	$33,853.10	$ 8,833.69	$25,019.41
3-31-42	19,400.59	5,628.50	13,772.09
3-31-43	15,298.44	9,366.78	5,931.66
3-31-44	16,944.89	7,884.86	9,060.03
Totals	$85,497.02	$31,713.83	$53,783.19

Declared Value Excess-Profits Tax.

4- 1-40 to 3-31-41	$10,265.16	$ None	$10,265.16
Totals	$10,265.16	$ None	$10,265.16

Excess Profits Tax.

4- 1-40 to 3-31-41	$ 22,352.95	$ None	$ 22,352.95
3-31-42	17,183.98	None	17,183.98
3-31-43	43,946.64	None	43,946.64
3-31-44	62,835.39	None	62,835.39
Totals	$146,318.96	$ None	$146,318.96
Grand Totals	$242,081.14	$31,713.83	$210,367.31

In making this determination of your income, declared value excess profits and excess profits tax liability, careful consideration has been given to the original report of examination dated May 7, 1945, to the supplemental report of examination dated November 25, 1946, to your pro-

test dated August 28, 1945, to the statements made at the conferences held on April 27, 1948, June 25, 1948 and September 13, 1948 and to your claims for refund filed on November 12, 1946 covering the years ended March 31, 1941 and 1944 and claims for refund filed on July 23, 1945 covering the years ended March 31, 1943 and 1944.

If a petition to the Tax Court of the United States is filed against the defiiciency proposed herein, the issues set forth in your claims for refund should be made a part of the petition to be considered by the Tax Court in any redetermination of your tax liability. If a petition is not filed, the claims for refund will be disallowed and official notice will be issued by registered mail in accordance with section 3772 of the Internal Revenue Code.

Pursuant to the provisions of section 45 of the Internal Reevnue Code portions of the gross income attributed to "Grenada Hosiery Mills", a purported partnership, have been allocated to you and included in your net income for the taxable years and in the amounts set forth below, to-wit:

Fiscal year ended March 31, 1941	$62,068.57
Fiscal year ended March 31, 1942	29,164.11
Fiscal year ended March 31, 1943	30,189.53
Fiscal year ended March 31, 1944	45,893.73

In the alternative it is held that said purported partnership is without substance and that said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Abar Process Company", a purported partnership, have been allocated to you and included in your net income for the taxable years and in the amounts set forth below, to-wit:

Fiscal year ended March 31, 1942	$116.14
Fiscal year ended March 31, 1943	338.85
Fiscal year ended March 31, 1944	547.70

In the alternative it is held that said purported partnership is without substance and that said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

A copy of this letter and statement has been mailed to your representatives, Mr. Arthur L. Gillom, Consolidated Building, Indianapolis 4, Indiana, Mr. Robert A. Littleton, Tower Building, Washington, D. C. and Messrs. Charles E. Stevens and Milton Elrod, Jr., Circle Tower, Indianapolis 4, Indiana, in accordance with the authority contained in the power of attorney executed by you and on file with this office.

Adjustments to Net Income.

Taxable Year ended March 31, 1940.

Net income as disclosed by return (loss) ...	($46,867.50)
Unallowable deductions and additional income:	
(a) Prepaid manufacturing expense	$ 6,356.40

(b) Reserve for overhauling machines	16,076.22	
(c) Depreciation	2,358.60	
(d) Rental on machines	15,302.70	40,093.92
Total		$ 6,773.58
Nontaxable income and additional deductions:		
(e) Capital stock tax		336.00
Net income adjusted (less)		($7,109.58)

Explanations of Adjustments.

(a) It is determined that the deduction of $6,356.40, representing operating expenses incurred in a prior year, is not allowable under the provisions of section 23(a) or any other section of the Internal Revenue Code.

(b) It is determined that the deduction of $16,076.22, representing an amount set aside as a reserve for overhauling machines, is not allowable under the provisions of section 23(a) or any other section of the Internal Revenue Code.

(c) It is determined that the deduction of $8,310.23 claimed for depreciation under the provisions of section 23(l) of the Internal Revenue Code is excessive by the amount of $2,358.60.

(d) It is determined that the deduction of $50,054.46, claimed for rental of machines from Grenada Hosiery Mills under the provisions of section 23(a) of the Internal Revenue Code, is excessive by the amount of $15,302.70.

(e) It is determined that the deduction of $225.00 claimed by you on your return for capital stock tax under the provisions of section 23(c) of the Internal Revenue Code, is understated by the amount of $336.00 as provided by Section 43 of the Internal Revenue Code.

Adjustments to Net Income.

Taxable Year Ended March 31, 1941.

Net income as disclosed by return	$ 37,421.93
Unallowable deductions and additional income:	
(a) Prepaid manufacturing expense	6,234.15
(b) Rental on machines	20,068.70
(c) Depreciation	1,888.97
(d) Net operating loss	23,681.70
(e) Grenada Hosiery Mills	62,068.57
(f) Capital loss	88.50
Total	$151,452.52
Nontaxable income and additional deductions:	
(g) Capital stock tax	132.81
Net income adjusted	$151,319.71

Explanations of Adjustments.

(a) It is determined that the deduction of $6,234.15, representing operating expenses incurred in a prior year is not allowable under the provisions of section 23(a) or any other section of the Internal Revenue Code.

(b) It is determined that the deduction of $55,179.72, claimed by you for rental of machines from Grenada Hosiery Mills under the provisions of section 23(a) of the Internal Revenue Code, is excessive by the amount of $20,068.70.

(c) It is determined that the deduction of $8,325.48 claimed for depreciation under the provisions of section 23(l) of the Internal Revenue Code is excessive by the amount of $1,888.97.

(d) It is determined that the net operating loss deduction of $30,791.28 claimed by you under the provisions of section 23(a) and section 122 of the Internal Revenue Code is overstated by the amount of $23,681.70 as shown by the recomputation of the net loss for the year ended March 31, 1940 in this statement.

(e) Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Grenada Hosiery Mills", a purported partnership, have been allocated to you and included in your net income for the fiscal year ended March 31, 1941 in the amount of $62,068.57.

In the alternative it is held that said purported partnership is without substance and that said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

(f) It is determined that the net long term capital loss of $88.50 claimed by you on line 11(b) of your income tax return must be eliminated under the pro-

visions of section 122 of the Internal Revenue Code in allowing a net operating less deduction.

(g) It is determined that the deduction of $1,117.19 claimed by you on your return for capital stock tax under the provisions of section 23(c) of the Internal Revenue Code, is understated by the amount of $132.81 as provided by section 43 of the Internal Revenue Code.

Year ended March 31, 1941.

Computation of Tax.

Declared Value Excess-Profits and Declared Value Excess-Profits Defense Tax Computation.

Value of capital stock as declared in the capital stock tax return for year ended June 30, 1940	$588,426.97		
Net income for declared value excess-profits tax computation ...	151,319.71		
Less Dividends received credit ...	None		
Balance of net income	$151,319.71		
Less: 10 percent of capital stock declared value	58,842.70		
Net income subject to declared value excess-profits tax	$ 92,477.01		
Amount taxable at 6 percent	29,421.35		
Amount taxable at 12 percent ...		$63,055.66	
Declared value excess-profits tax (6 percent of $29,421.35)		1,765.28	
Declared value excess-profits tax (12 percent of $63,055.66)		7,566.68	
Total declared value excess-profits tax			9,331.96
Declared value excess-profits defense tax (10 percent of $9,331.96)			933.20

Total declared value excess profits and declared value excess-profits defense taxes	$10,265.16
Assessed: Mississippi August 1941 list, Account No. 41035	None
Deficiency	$10,265.16

Income Tax Computation.

Net income for declared value excess-profits tax computation	$151,319.71
Less: Declared value excess-profits and declared value excess-profits defense taxes	10,265.16
Net income	$141,054.55
Less: Interest on obligations of the United States	None
Adjusted net income	$141,054.55
Less: Dividends received credit	None
Normal-tax net income	$141,054.55
Income tax (22.1% of $141,054.55)	31,173.06
Income defense tax (1.9% of $141,054.55)	2,680.04
Total income and income defense taxes	$ 33,853.10
Total income and income defense taxes assessed: Mississippi August 1941 list, account No. 41035	8,833.69
Deficiency	$ 25,019.41

Adjustments to Excess Profits Net Income.

Taxable Year ended March 31, 1941.

Invested Capital Method.

Excess Profits net income as disclosed by return	$ 31,061.33
Unallowable deductions and additional income:	
(a) Increase in normal tax net income ...	103,632.62
Total	$134,693.95
Nontaxable income and additional deductions:	
(b) Increase in income and income defense taxes	25,019.41
Excess Profits net income adjusted	$109,674.54

Explanations of Adjustments.

(a) It is determined under the provisions of section 711(a) of the Internal Revenue Code that excess profits net income should be adjusted by the increase in normal tax net income shown by this statement.

Normal tax net income as corrected	$141,054.55
Normal tax net income per return	37,421.93
Increase	$103,632.62

(b) It is determined under the provisions of section 711(a) of the Internal Revenue Code that excess profits net income should be adjusted by the increase in income and income defense taxes shown by this statement.

Year ended March 31, 1941.

Excess Profits Credit Based on Invested Capital.

Invested Capital.

	Per Return	Adjustments Increase	Adjustments Decrease	Corrected
Equity invested capital at beginning of taxable year	$401,907.59		(a)$22,843.45	$379,962.14
Average additions during year	None			None
Total	$401,907.59			$379,062.14
Average reductions during year	None			None
Average equity invested capital	$401,907.59			$379,062.14
Average borrowed invested capital	3,144.77	(b)2,905.34		6,050.11
Average invested capital	$405,052.36			$385,112.25
Reduction on account of inadmissible assets	None			None
Invested capital	$405,052.36	2,905.34	22,845.45	$385,112.25

Excess Profits Credit.

Portion of invested capital and applicable credit $385,112 8% $30,808.98.

Explanation of Adjustments.

Year Ended March 31, 1941.

(a) It is determined under the provisions of section 718(a) of the Internal Revenue Code that equty invested capital should be decreased by the amount of $22,845.45.

(b) It is determined under the provisions of section 719 of the Internal Revenue Code that average borrowed invested capital should be increased by the amount of $2,905.34.

Year ended March 31, 1941.

Excess Profits Tax Computation.

Excess profits net income		$109,674.54		
Less: Specific exemption	$ 5,000.00			
Excess profits credit	30,808.98	35,808.98		
Adjusted excess profits net income		73,865.56		
Portion $0 to $20,000		20,000.00	25%	$ 5,000.00
Portion $20,000 to $50,000		30,000.00	30%	9,000.00
Portion $50,000 to $100,000 ...		23,865.56	35%	8,352.95
Correct excess profits tax liability				$22,352.95
Previous assessment: August 1941 list, Account No. 80572				None
Deficiency in excess profits tax				$22,352.95

Adjustments to Net Income.

Taxable Year ended March 31, 1942.

Net income as disclosed by return	$24,514.00
Unallowable deductions and additional income:	
(a) Prepaid manufacturing expense	6,356.35
(b) Rental on machines	17,581.87
(c) Depreciation	2,048.71
(d) Grenada Hosiery Mills	29,164.11
(e) Abar Process Co.	116.14
(f) Capital stock tax	791.80
Net income adjusted	$80,572.98

Explanations of Adjustments.

(a) It is determined that the deduction of $6,356.35, representing operating expenses incurred in a prior year, is not allowable under the provisions of section 23(a) or any other section of the Internal Revenue Code.

(b) It is determined that the deduction of $52,760.91, claimed by you for rental of machines from Grenada Hosiery Mills under the provisions of section 23(a) of the Internal Revenue Code, is excessive by the amount of $17,581.87.

(c) It is determined that the deduction of $8,754.02 claimed for depreciation under the provisions of section 23(l) of the Internal Revenue Code is excessive by the amount of $2,048.71.

(d) Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attri-

buted to "Grenada Hosiery Mills", a purported partnership, have been allocated to you and included in your net income for the taxable year ended March 31, 1942 in the amount of $29,164.11.

In the alternative it is held that said purported partnership is without substance and that said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

(e) Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Abar Process Company", a purported partnership, have been allocated to you and included in your net income for the taxable year ended March 31, 1942 in the amount of $116.14.

In the alternative it is held that said purported partnership is without substance and that said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

(f) It is determined that the deduction of $2,041.80 claimed by you on your return for capital stock tax under the provisions of section 23(c) of the Internal Revenue Code is overstated by the amount of $791.80.

Year ended March 31, 1942.

Computation of Tax.

Declared Value Excess-Profits Tax Computation.

Net income for declared value excess-profits tax computation ..... $ 80,572.98

Less: 10 per cent of $1,000,000.00 value of capital stock as declared or as adjusted for the year ended June 30, 1941	100,000.00
Net income subject to declared value excess-profits tax	$ None
Total declared value excess-profits tax	$ None
Declared value excess-profits tax assessed: Mississippi October 1942 list, Acct. No. 410002	None
Deficiency—Overassessment of declared value excess-profits tax	None

Income Tax Computation.

Net income for declared value excess-profits tax computation	$ 80,572.98
Less:	
Declared value excess-profits tax	None
Net income for capital stock tax purposes	$ 80,572.98
Less: Excess profts tax	$ 17,183.98
Normal-tax net income and surtax net income	$ 63,389.00

Year ended March 31, 1942.

Normal tax (24 percent of normal-tax net income)			$ 15,213.36
	Net Income	Portion of surtax Rate	Amount of tax
Portion of surtax net income (not in excess of $25,000); and tax	$25,000.00	6%	$ 1,500.00

Portion of surtax net income (not in excess of $25,000); and tax	38,389.00	7%	2,687.23
Total surtax			$ 4,187.23
Total normal tax and surtax			19,400.59
Income tax assessed: Mississippi October 1942 list, Account No. 410002			$ 5,628.50
Deficiency			$13,772.09

Adjustments to Excess Profits Net Income.

Taxable Year ended March 31, 1942.

Invested Capital Method.

Excess Profits net income as disclosed by return	$24,887.55
Unallowable deductions and additional income:	
(a) Increase in normal tax net income	56,058.98
Excess Profits net income adjusted	$80,946.53

Explanatons of Adjustments.

(a) It is determined under the provisions of section 711(a) of the Internal Revenue Code that excess profits net income should be adjusted by the increase in normal tax net income shown by this statement.

Normal tax net income as corrected	$80,572.98
Normal tax net income per return	24,514.00
Increase	$56,058.98

Year ended March 31, 1942.

Excess Profits Credit Based on Invested Captal.

Invested Capital.

	Per Return	Adjustments Decrease	Corrected
Equity invested capital at beginning of taxable year	$439,332.52	(a)60,270.38	$379,062.14
Average additions during year	None		None
Total	$439,332.52		$379,062.14
Average reductions during year	None		None
Average equity invested capital	$439,332.52		$379,062.14
Average borrowed invested capital	2,944.90	(b) 924.84	2,020.06
Average invested capital	$442,277.42		$381,082.20
Reduction on account of inadmissible assets	None		None
Invested capital	$442,277.42		$381,082.20

Excess Profits Credit.

Portion of invested capital and applicable credit $381,-082.20 8% $30,486.58.

Explanation of Adjustments.

Year Ended March 31, 1942.

(a) It is determined under the provisons of section 718(a) of the Internal Revenue Code that equity invested capital should be decreased by the amount of $60,270.38.

(b) It is determined under the provisions of section 719 of the Internal Revenue Code that average borrowed invested capital should be decreased by the amount of $924.84.

Year ended March 31, 1942.

Excess Profits Tax Computation.

Excess Profits net income		$80,946.53	
Less:			
Specific exemption	$ 5,000.00		
Excess profits credit	30,486.58	35,486.58	
Adjusted excess profits net income		$45,459.95	
Portion $.. to $20,000.00		20,000.00 35%	$ 7,000.00
Portion $20,000 to $50,000		25,459.95 40%	10,183.98
Correct excess profits tax liability			$17,183.98

Previous assessment: Mississippi October 1942 list account No. 800413	None
Deficiency in excess profits tax	$17,183.98

Adjustments to Net Income.

Taxable Year ended March 31, 1943.

Net income as disclosed by return		$ 41,168.98
Unallowable deductions and additional income:		
(a) Capital expenditures		1,119.12
(b) Prepaid manufacturing expense		6,356.35
(c) Rental on machines		21,523.33
(d) Grenada Hosiery Mills		30,189.53
(e) Abar Process Company		338.85
(f) Depreciation		438.28
Total		$101,134.44
Nontaxable income and additional deductions:		
(g) Capital Stock tax	$2,500.00	
(h) Additional amortization of special facilities	8,675.72	$ 11,175.72
Net income adjusted		$ 89,958.72

Explanations of Adjustments.

(a) It is determined that the deduction of $267.00 for improvements to leasehold and the deduction of $852.12 for gravel in making cement walks constitute capital expenditures which are not allowable under the provisions of section 24(a)(2) of the Internal Revenue Code.

(b) It is determined that the deduction of $6,356.35, representing operating expenses incurred in a prior year is not allowable under the provisions of section 23(a) or any other section of the Internal Revenue Code.

(c) It is determined that the deduction of $56,707.47, claimed by you for rental of machines from Grenada Hosiery Mills under the provisions of section 23(a) of the Internal Revenue Code, is excessive by the amount of $21,523.33.

(d) Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Grenada Hosiery Mills", a purported partnership, have been allocated to you and included in your net income for the fiscal year ended March 31, 1943 in the amount of $30,189.53.

In the alternative it is held that said purported partnership is without substance and that said portions of the income which were attributed to said purported partnershp are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

(e) Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Abar Process Company", a purported partnership, have been allocated to you and included in your net income for the fiscal year ended March 31, 1943 in the amount of $338.85.

In the alternative it is held that said purported partnership is without substance and that said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

(f) It is determined that the deduction of $8,791.31 claimed for depreciation under the provisions of section 23(l) of the Internal Revenue Code is excessive by the amount of $1,953.28.

It is determined that a deduction of $1,515.00 is allowable under the provisions of section 23(l) of the Internal Revenue Code for depreciation on the Mississippi Division.

(g) It is determined that the deduction of $1,250.00 claimed by you on your return for capital stock tax under the provisions of section 23(c) of the Internal Revenue Code is understated by the amount of $2,500.00.

(h) It is determined that the deduction of $21,276.86 claimed by you on your return for amortization under the provisions of section 23(t) of the Internal Revenue Code should be increased by the amount of $8,675.72 as provided by section 124(d)(1) of the Internal Revenue Code.

Year ended March 31, 1943.

Computation of Tax.

Declared Value Excess Profits Tax Computation.

Net income for declared value excess-profits tax computation	$ 89,958.72
Less: 10 percent of $1,000,000.00 value of capital stock as declared for the year ended June 30, 1942	100,000.00
Net income subject to declared value excess-profits tax	$ None
Total declared value excess-profits tax	None

Declared value excess-profits tax previously assessed: Mississippi June 1943 list, Account No. 410012	None
Deficiency—Overassessment of declared value excess-profits tax	None

Income Tax Computation.

Net income for declared value excess-profits tax computation	$ 89,958.72
Less: Declared value excess-profits tax	None
Net income	$ 89,958.72
Less: Income subject to excess profits tax	48,829.60
Normal-tax net income and surtax net income	$ 41,129.12

Year ended March 31, 1943.

Normal-tax net income			$41,129.12
	Portion	Rate	
Portion of normal-tax net income (not in excess of $5,000); and tax	$ 5,000.00	15%	$ 750.00
Portion of normal-tax net income (in excess of $5,000 and not in excess of $20,000); and tax	15,000.00	17%	2,550.00
Portion of normal-tax net income (in excess of $20,000 and not in excess of $25,000); and tax	5,000.00	19%	950.00

	Portion	Rate	
Portion of normal-tax net income (in excess of $25,000); and tax	16,129.12	21%	5,000.03
Total normal tax			$ 9,250.03
Portion of surtax net income (not in excess of $25,000); and tax	25,000.00	10%	$ 2,500.00
Portion of surtax net income (in excess of $25,000 and not in excess of $50,000); and tax	16,129.12	22%	$3,548.41
Total surtax			$ 6,048.41
Total normal tax and surtax			15,298.44
Income tax assessed: Mississippi June 1943 list, Account No. 410012			$15,319.56
Less: Tentative amortization allowance, Schedule No. A M-880		5,952.78	9,366.78
Deficiency of income tax			$ 5,931.66

Adjustments to Excess Profits Net Income.

Taxable Year ended March 31, 1943.

Invested Capital Method.

Excess Profits net income as disclosed by return	$42,784.13
Unallowable deductions and additional income:	
(a) Increase in normal tax net income	48,789.74
Excess Profits net income adjusted	$91,573.87

Explanations of Adjustments.

(a) It is determined under the provisions of section 711(a) of the Internal Revenue Code that excess profits net income should be adjusted by the increase in normal tax net income shown by this statement.

Normal tax net income as corrected	$89,958.72
Normal tax net income per return	41,168.98
Increase	$48,789.74

Year ended March 31, 1943.

Excess Profits Credit Based on Invested Capital.

Invested Capital.

	Per Return	Adjustments Decrease	Corrected
Equity invested capital at beginning of taxable year	$417,555.40	(a)$38,493.26	$379,062.14
Average additions during year	None		None
Total	$417,555.40		$379,062.14
Average reductions during year	None		None
Average equity Invested capital	$417,555.40		$379,062.14
Average borrowed invested capital	130,892.63	(b) 38,151.41	92,741.22
Average invested			

	Per Return	Adjustments Decrease	Corrected
capital	548,448.03		471,803.36
Reduction on account of inadmissible assets	None		None
Invested capital ...	$548,448.03	$76,644.67	$471,803.36

Excess Profits Credit.

Portion of invested capital and applicable credit $471,-803.36 8% $37,744.27.

Explanation of Adjustments.

Year ended March 31, 1943.

(a) It is determined under the provisions of section 718(a) of the Internal Revenue Code that equity invested capital should be decreased by the amount of $38,493.26.

(b) It is determined under the provisions of section 719 of the Internal Revenue Code that average borrowed invested capital should be decreased by the amount of $38,151.41.

Year ended March 31, 1943.

Excess Profits Tax Computation.

Excess profits net income $91,573.87

Less:		
Specific exemption	$ 5,000.00	
Excess profits credit	37,744.27	42,744.27
Adjusted excess profits net income		$48,829.60
90 per cent of $48,829.60		43,946.64
Surtax net income (computed without regard to the credit provided by Sec. 26(e)		89,958.72
80 per cent of $89,958.72		71,966.98
Income tax		15,298.44
Excess		56,668.54
Lesser amount		43,946.64
Correct excess profits tax liability		43,946.64
Previous assessment: Mississippi list, account No. 63810		None
Deficiency in excess profits tax		43,946.64

Post War Refund of Excess Profits Tax and Credit for Debt Retirement.

Balance of excess profits tax	43,946.64
Credit allowable under sections 780 and 781	4,394.66
Net reduction in indebtedness under Sec. 783	None
Credit for debt retirement under Sec. 783	None
Net post war refund	$ 4,394.66

Adjustments to Net Income.

Taxable Year ended March 31, 1944.

Net income as disclosed by return	$ 50,539.00
Unallowable deductions and additional income:	
(a) Capital expenditures	7,217.26
(b) Prepaid manufacturing expense	6,356.35
(c) Capital stock tax	1,850.00

(d) Rental on machines		17,561.41
(e) Grenada Hosiery Mills		45,893.73
(f) Abar Process Company		547.70
Total		$129,965.45
Nontaxable income and additional deductions:		
(g) Depreciation	$ 1,532.44	
(h) Contributions	1,001.05	
(i) Amortization	14,279.28	$ 16,812.77
Net income adjusted		$113,152.68

Explanations of Adjustments.

(a) It is determined that the deduction of $4,680.15 for improvements to leasehold, machinery, beauty shop and cafe equipment and the deduction of $2,537.11 for fluorescent light fixtures and tile flooring constitute capital expenditures which are not allowable under the provisions of section 24(a)(2) of the Internal Revenue Code.

(b) It is determined that the deduction of $6,356.35, representing operating expenses incurred in a prior year, is not allowable under the provisions of section 23(a) or any other section of the Internal Revenue Code.

(c) It is determined that the deduction of $6,850.00 claimed by you on your return for capital stock tax under the provisions of section 23(c) of the Internal Revenue Code, is overstated by the amount of $1,850.00.

(d) It is determined that the deduction of $52,745.55 claimed by you for rental of machines from Grenada Hosiery Mills under the provisions of section 23(a) of

the Internal Revenue Code, is excessive by the amount of $17,561.41.

(e) Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Grenada Hosiery Mills", a purported partnership, have been allocated to you and included in your net income for the fiscal year ended March 31, 1944 in the amount of $45,893.73.

In the alternative it is held that said purported partnership is without substance and that said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

(f) Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Abar Process Company", a purported partnership, have been allocated to you and included in your net income for the fiscal year ended March 31, 1944 in the amount of $547.70.

In the alternative it is held that said purported partnership is without substance and that said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

(g) It is determined that the deduction of $8,962.55 claimed for depreciation under the provisions of section 23(l) of the Internal Revenue Code is excessive by the amount of $1,917.99.

It is determined that a deduction of $3,450.43 is allowable under the provisions of section 23(l) of the Internal Revenue Code for depreciation on the Mississippi Division.

(h) It is determined that the deduction of $2,659.95 claimed by you for contributions should be increased by the amount of $1,001.05 under the provisions of section 23(q) of the Internal Revenue Code.

(i) It is determined that the deduction of $38,794.64 claimed by you on your return for amortization the provisions of section 23(t) of the Internal Revenue Code should be increased by the amount of $14,279.28 as provided by section 124(d)(1) of the Internal Revenue Code.

Year ended March 31, 1944.

Computation of Tax.

Declared Value Excess Profits Tax Computation.

Net income for declared value excess-profits tax computation	$113,152.68
Less: 10 percent of $3,000,000.00 value of capital stock as declared for the year ended June 30, 1943	300,000.00
Net income subject to declared value excess-profits tax	$ None
Total declared value excess-profits tax	None
Declared value excess-profits tax previously assessed: October 1944 list, Account No. 410023	None
Deficiency—Overassessment of declared value excess-profits tax	None

Income Tax Computation.

Net income for declared value excess-profits tax computation	$113,152.68
Less: Declared value excess-profits tax	None
Net income	$113,152.68
Less: Income subject to excess profits tax	68,917.04
Normal-tax net income and surtax net income	$ 44,235.64

Year ended March 31, 1944.

Normal-tax net income			$ 44,235.64
	Portion	Rate	Amount of tax
Portion of normal-tax net income (not in excess of $5,000); and tax	$ 5,000.00	15%	$ 750.00
Portion of normal-tax net income (in excess of $5,000 and not in excess of $20,000); and tax	15,000.00	17%	2,550.00
Portion of normal-tax net income (in excess of $20,000 and not in excess of $25,000); and tax	5,000.00	19%	950.00
Portion of normal-tax net income (in excess of $25,000); and tax	19,235.64	31%	5,963.05
Total normal tax			$10,213.05
Portion of surtax net income (not in excess of $25,000); and tax	25,000.00	10%	2,500.00

Portion of surtax net income (in excess of $25,000 and not in excess of $50,000); and tax	19,235.64	22%	231.84
Total surtax			$ 6,731.84
Total normal tax and surtax			$16,944.89
Income tax assessed: October 1944 list, Account No. 410023	$20,215.60		
Less: Tentative amortization adjustment, Schedule No. AM-880	12,330.74		7,884.86
Deficiency of income tax			$ 9,060.03

Computation of Income Subject to Excess Profits Tax.

Year ended March 31, 1944.

	Annual Basis	Fractional Year	Actual
Income subject to excess profits tax			
1943 basis	70,160.21	275/366	$52,716.00
1944 basis	65,160.21	91/366	16,201.04
Total			$68,917.04

Adjustments to Excess Profits Net Income.

Taxable Year ended March 31, 1944.

Invested Capital Method.

Excess profits net income as disclosed by return	$ 53,702.00

Unallowable deductions and additional income:	
(a) Increase in normal tax net income	62,613.68
Excess Profits net income adjusted	$116,315.68

Explanations of Adjustments.

(a) It is determined under the provisions of section 711(a) of the Internal Revenue Code that excess profits net income should be adjusted by the increase in normal tax net income shown by this statement.

Normal tax net income as corrected	$113,152.68
Normal tax net income per return	50,539.00
Increase	$ 62,613.68

Year ended March 31, 1944.

Excess Profts Credit Based on Invested Capital.

Invested Capital.

	Per Return	Adjustments Increase	Adjustments Decrease	Corrected
Equity invested capital at beginning of taxable year	$385,028.37		(a) $5,966.23	$379,062.14
Average additions during year	None			None
Total	$385,028.37			$379,062.14
Average reductions during year	None			None
Average equity invested capital	$385,028.37			$379,062.14
Average borrowed invested capital	243,533.25		(b)103,676.69	139,856.56
Average invested capital	$628,561.62			$518,918.70
Reduction on account of inadmissible assets	7,447.90	(c)2,972.54		4,475.36
Invested capital	$621,113.72	2,972.54	109,642.92	514,443.34

Excess Profits Credit.

Portion of invested capital and applicable credit $514,-443.34 8% $41,155.47.

Year ended March 31, 1944.

Explanation of Adjustments.

(a) It is determined under the provisions of section 718(a) of the Internal Revenue Code that equity invested capital should be decreased by the amount of $5,-966.23.

(b) It is determined under the provisions of section 719 of the Internal Revenue Code that average borrowed invested capital should be decreased by the amount of $103,676.69.

(c) It is determined under the provisions of section 720 of the Internal Revenue Code that the reduction on account of inadmissible assets should be decreased by the amount of $2,972.54.

Year ended March 31, 1944.

Excess Profits Tax Computation.

	1943 Basis	1944 Basis
Excess profits net income	$116,315.68	$116,315.68
Less:		
Specific exemption	5,000.00	10,000.00
Excess profits credit	41,155.47	47,155.47
Adjusted excess profits net income	$ 70,160.21	$ 65,160.21

90 or 95 percent of above line ...	63,144.19	61,902.20
Surtax net income (computed without regard to the credit provided by Sec. 26(e)	113,152.68	113,152.68
80 percent of $113,152.68	90,522.14	90,522.14
Income tax	16,944.89	16,944.89
Excess	73,577.25	73,577.25
Lesser amount	63,144.19	61,902.20
Excess Profits tax:		
1943 Basis, $63,144.19 x 275/366		47,444.41
1944 Basis, $61,902.20 x 91/366		15,390.98
Correct excess profits tax liability		62,835.39
Previous assessment: October 1944 list, Account No. 801674		None
Deficiency in excess profits tax		62,835.39

Post War Refund of Excess Profits Tax and Credit for Debt Retirement.

Balance of excess profits tax	62,835.39
Credit allowable under sections 780 and 781	6,283.54
Net reduction in indebtedness under Sec. 783	None
Credit for debt retirement under Sec. 783	None
Net post war refund	6,283.54

ANSWER.

Received Jan. 3, 1950.

Filed Jan. 3, 1950.

The Tax Court of the United States.

Grenada Industries, Inc., Petitioner,
v. Docket No. 24571.
Commissioner of Internal Revenue, Respondent.

Comes Now the Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits, alleges, avers and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition, except it is denied that the income and excess profits tax returns of petitioner for the taxable year ended March 31, 1944, were filed with the Collector of Internal Revenue for the District of Mississippi.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits that the taxes in controversy are income and excess profits taxes for the taxable years ended March 31, 1941, 1942, 1943, and 1944 and declared value excess-profits tax for the taxable year ended March 31, 1941. Denies the remaining allegations contained in paragraph 3 of the petition.

4(a) and (b). Denies that the respondent erred as alleged in subparagraphs (a) and (b) of paragraph 4 of the petition.

4(c). Avers that by virtue of its order dated November 9, 1949, granting respondent's motion to dismiss the instant petition in so far as it related to relief under section 722 of the Internal Revenue Code, the Court has stricken the purported assignment of error contained in subparagraph (c) of paragraph 4 of the petition.

5(a). Denies the allegations contained in subparagraph (a) of paragraph 5 of the petition, except it is admitted that the words enclosed by quotation marks are contained in the statement attached to the notice of deficiency mailed on June 2, 1949.

5(b) and (c). Denies the allegations contained in subparagraphs (b) and (c) of paragraph 5 of the petition.

5(d). Avers that the allegations contained in subparagraph (d) of paragraph 5 of the petition consist of argumentative and immaterial matter and conclusions which should be stricken or disregarded.

Further answering said subparagraph, respondent denies all material allegations of fact, if any, contained therein.

5(e). Denies the allegations contained in subparagraph (e) of paragraph 5 of the petition.

5(f). Denies the allegations contained in subparagarph (f) of paragraph 5 of the petition, except it is admitted that the words enclosed by quotation marks are con-

tained in the statement attached to the notice of deficiency mailed on June 2, 1949.

5(g). Denies the allegations contained in subparagraph (g) of paragraph 5 of the petition.

5(h). Avers that the allegations contained in the first sentence of subparagraph (h) of paragraph 5 of the petition consist of argumentative and immaterial matter and conclusions which should be stricken or disregarded. Further answering said sentence of subparagraph (h) of paragraph 5 of the petition, respondent denies the material allegations of fact, if any, contained therein.

Denies the allegations contained in the second, third and fourth sentences of subparagraph (h) of paragraph 5 of the petition.

5(i), (j) and (k). Avers that by virtue of its order dated November 9, 1949, granting respondent's motion to dismiss the instant petition in so far as it related to relief under section 722 of the Internal Revenue Code, the Court has stricken the allegations contained in subparagraphs (i), (j) and (k) of paragraph 5 of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified, or denied.

Wherefore, it is prayed that the petitioner's appeal be denied.

(Signed) CHARLES OLIPHANT, LMP.
(Charles Oliphant),
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:
PHILIP M. CLARK,
Division Counsel.
LESTER M. PONDER,
Special Attorney,
Bureau of Internal Revenue.

---

17 T. C. No. 28.

The Tax Court of the United States.

Grenada Industries, Inc., Petitioner,
v.
Commissioner of Internal Revenue, Respondent.

National Hosiery Mills, Inc., Petitioner,
v.
Commissioner of Internal Revenue, Respondent.

Docket Nos. 24571, 24640.

Promulgated August 22, 1951.

Two corporations—Industries and National—and two partnerships—Hosiery and Abar—were owned or controlled directly or indirectly by the same interests. On respondent's allocation of the income of the two part-

nerships to the two corporations, held, (1) allocation of Abar's income to the two corporations disapproved; (2) allocation of Hosiery's income to Industries approved; (3) allocation of Hosiery's income to National disapproved.

Robert A. Littleton, Esq., for the petitioners.

Lester M. Ponder, Esq., for the respondent.

The Commissioner determined the following deficiencies:

Docket No.	Year Ended Mar. 31	Income Tax	Declared Value Excess Profits Tax	Excess Profits Tax	Penalty on Excess Profits Tax
24571	1941	$25,019.41	$10,265.16	$22,352.95	—
	1942	13,772.09	—	17,183.98	—
	1943	5,931.66	—	43,946.64	—
	1944	9,060.03	—	62,835.39	—
	Year				
24640	1940	7,708.93	1,794.24	—	—
	1941	7,510.32	—	14,467.34	—
	1942	10,535.14	1,870.81	2,650.24	—
	1943	—	1,570.68	34,485.08	$1,724.25

These proceedings were consolidated for hearing. They present the issue whether respondent erred in allocating to petitioners income claimed to have been earned by two other enterprises. In both proceedings, the determined deficiencies rested in part on other adjustments, but the validity of these other adjustments is conceded by both petitioners. In Docket No. 24640, a 5 per cent penalty, amounting to $1,724.25, was added because of late filing of an excess profits tax return for the taxable period ending December 31, 1943, and the validity of this penalty is also conceded.

FINDINGS OF FACT.

Petitioner in No. 24571, Grenada Industries, Inc. (hereinafter sometimes referred to as "Industries"), is a corporation organized under the laws of the State of Mississippi, with its principal office at Grenada, Mississippi. For its fiscal years ending March 31, 1941, 1942, and 1943, it filed its tax returns in question with the collector of internal revenue for the district of Mississippi. For its fiscal year ending March 31, 1944, it filed its returns with the collector of internal revenue for the district of Indiana. Petitioner in No. 24640, National Hosiery Mills, Inc. (hereinafter sometimes referred to as "National"), is a corporation organized under the laws of the State of Indiana, with its principal office at Indianapolis, Indiana. For its tax years under review, it filed its returns with the collector of internal revenue for the district of Indiana.

The ladies' hosiery industry consists of a number of recognized and distinct phases, which include: (1) Manufacturing unfinished and undyed hosiery, or hosiery "in the grey",[1] for which there is a market; (2) dyeing and finishing hosiery "in the grey"; (3) developing and furnishing, to manufacturing and finishing mills, expert styling and merchandising specifications and ideas; (4) selling finished hosiery to the trade; (5) salvaging yarn and defective hosiery, by reclaiming yarn from waste and defective hosiery, and by mending defective hosiery and selling it to the trade. Many persons and businesses engage only in one or more of these phases of the industry.

[1] "Grey" is sometimes used interchangeably with "gray" and "greige". In the "grey" stage, the hosiery has been fully knitted, looped and seamed from the raw yarn, but remains to be dyed and finished.

Jacob A. Goodman (hereinafter also referred to as "J. A. Goodman") and Lazure L. Goodman (hereinafter also referred to as "L. L. Goodman") were brothers who had been engaged in the ladies' hosiery industry since 1915. At that time they operated their own business as hosiery distributors in Indianapolis and North Carolina. In or about 1920 they organized Real Silk Hosiery Mills, Incorporated (hereinafter referred to as "Real Silk"), which came to engage in all the above-described phases of the industry. The Goodmans dominated and controlled Real Silk as long as they continued their affiliation with it, until 1937, and they acquired eminent reputations in the industry. They were responsible for Real Silk's successful merchandising and sales operations, and had extensive experience in merchandising and selling ladies' hosiery.

In 1925 Real Silk opened a salvaging department, prior thereto having sold its waste and defective hosiery. Abraham J. Barskin (hereinafter referred to as "Barskin"), who at one time had independently been in the business of dealing in waste and defective merchandising, was put in charge of that department. Barskin was related to the Goodmans through marriage to their sister, who died in 1940.

Henry V. Kobin (hereinafter referred to as "Kobin") had been associated with the Goodmans at Real Silk. He entered Real Silk's employ in 1921. Theretofore the Goodmans had taken his brother, William Kobin, into the business. When William died in 1928, Kobin left Real Silk and, with the participation of the Goodmans, organized National. The Goodman family made investments in National. National engaged in the production, dyeing, finishing, and merchandising phases of the industry. In 1937 National organized a sales force; up to that time

National sold its product through the sales organization of the Trojan Division of Real Silk. Kobin was familiar with all phases of National's operations and he, like the Goodmans, attained wide experience in the indsutry. In 1928 Barskin also left Real Silk and joined Kobin at National, where he held executive office and assisted in the manufacturing phase of the business.

Israel E. Solar (hereinafter referred to as "Solar") likewise was associated with the Goodmans at Real Silk. He was hired by Real Silk in 1923, at the age of sixteen, and advanced rapidly in the organization. He remained with Real Silk, except for a brief period, until 1937. Almost his entire business career was spent in the hosiery industry, and during this period he has had close business relations with Goodmans and has been associated with companies with which the Goodmans were connected. While at Real Silk, he also knew Kobin and Barskin.

Charles E. Stevens (hereinafter referred to as "Stevens") was an accountant, who was employed by Real Silk in 1928. Prior to that time he had miscellaneous accounting experience. He remained as an employee of Real Silk until about 1932, when he left to go into the private practice of accounting, with his office at Indianapolis. Shortly thereafter he was retained by National, and supervised its accounting affairs. In his practice of accounting he specialized in tax and estate matters. He knew the Goodmans since about 1926 or 1927, and he advised the Goodmans and Kobin respecting the arrangement of their business affairs. Stevens had no technical training or experience in the hosiery industry.

At Stevens' advice, the Goodmans and Kobin created certain trusts for their children. L. L. Goodman had two children, Elliott R. and Sue Ellen, about 27 and 19 years

of age, respectively, at the time of the hearing. J. A. Goodman had three children, Robert A., Ruth Elaine, and Jacqueling, about 25, 22 and 23 years of age, respectively, at the time of the hearing. Kobin's children were William and Anne, about 22 and 19 years old, respectively, at the time of the hearing. Esther M. Goodman was the wife of L. L. Goodman; Sarah W. Goodman was the wife of J. A. Goodman; Florence Kobin was the wife of Henry V. Kobin. The Goodmans and Kobin set up the following trusts:

Trust	Date of Trust Indenture	Grantor
Elliot R. Goodman Trust No. 1	May 31, 1929	L. L. Goodman and E. M. Goodman
Trust No. 2	July 1, 1940	L. L. Goodman
Trust No. 3	Jan. 2, 1942	L. L. Goodman
Trust No. 4	Jan. 2, 1942	L. L. Goodman
Sue Ellen Godman Trust No. 1	July 25, 1931	L. L. Goodman
Trust No. 2	Oct. 14, 1940	L. L. Goodman
Trust No. 3	Oct. 8, 1941	L. L. Goodman
Robert A. Goodman Trust No. 1	Apr. 27, 1931	J. A. Goodman
Ruth Elaine Goodman Trust No. 1	Apr. 27, 1931	J. A. Goodman
Trust No. 2	Oct. 14, 1940	J. A. Goodman
Jacqueline Goodman Trust No. 1	Apr. 27, 1931	J. A. Goodman
Trust No. 2	July 1, 1940	J. A. Goodman
Trust No. 3	Oct. 8, 1941	J. A. Goodman
Trust No. 4	Jan. 2, 1942	J. A. Goodman
Trust No. 5	Jan. 2, 1942	J. A. Goodman
Anne Kobin Trust	June 3, 1932	H. V. Kobin
Wm. Kobin Trust	June 3, 1932	H. V. Kobin

Original Trustee	Successor Trustee	Successor Trustee
L. L. Goodman to 9/30/41	Security Trust Co. to 12/21/42	C. E. Stevens to date
J. A. Goodman to 9/30/41	Security Trust Co. to 12/21/42	C. E. Stevens to date
Security Trust Co. to 12/21/42	C. E. Stevens to date	
Security Trust Co. to 12/21/42	C. E. Stevens to date	
Esther Goodman to 9/30/41	Security Trust Co. to 12/21/42	C. E. Stevens to date
J. A. Goodman to 9/30/41	Security Trust Co. to 12/21/42	C. E. Stevens to date
Security Trust Co. to 12/21/42	C. E. Stevens to date	
Sarah Goodman to 9/30/41	Security Trust Co. to 12/21/42	C. E. Stevens to date
Sarah Goodman to 9/30/41	Security Trust Co. to 12/21/42	C. E. Stevens to date
A. J. Barskin to 9/30/41	Security Trust Co. to 12/21/42	C. E. Stevens to date
Sarah Goodman to 9/30/41	Security Trust Co. to 12/21/42	C. E. Stevens to date
A. J. Barskin to 9/30/41	Security Trust Co. to 12/21/42	C. E. Stevens to date
Security Trust Co. to 12/21/42	C. E. Stevens to date	
Security Trust Co. to 12/21/42	C. E. Stevens to date	
Security Trust Co. to 12/21/42	C. E. Stevens to date	
H. V. Kobin to 1/1/42	Security Trust Co. to 12/21/42	C. E. Stevens to date
H. V. Kobin to 1/1/42	Security Trust Co. to 12/21/42	C. E. Stevens to date

engaged in the manufacturing of hosiery in the grey. It lacked dyeing and finishing facilities, and did not have a sales organization. The machinery with which the plant was equipped was purchased by J. A. and L. L. Goodman and leased by them to Industries. It was a new type of knitting machinery imported from Europe. At that time the common method of manufacture of ladies' hosiery consisted of knitting the leg on one machine, and then transferring the leg to another machine which knitted the foot, resulting in a "double-unit" stocking. The machinery installed at Industries' plant, however, was equipped to knit the entire stocking in one operation on a single machine, producing a "single-unit" stocking. In 1938 Industries began operations experimentally in this new type stocking, working with employees new and inexperienced in the manufacture of this type of hosiery. During this period J. A. Goodman advised Industries respecting the design of this hosiery. Industries did not get into substantial operations until some time in 1938.

Industries' first operations were in silk hosiery, but it later began to work with nylon. However, nylon yarn was not readily obtainable, but the Goodmans, who enjoyed the confidence of the du Pont company which controlled the source of nylon, were able to obtain such yarn for Industries.

The capacity of National's dyeing and finishing facilities exceeded the quantity of its own grey goods production, and National used those facilities to process hosiery in the grey manufactured by other mills. Industries entered into an agreement with National, dated April 12, 1938, for the dyeing and finishing of Industries' hosiery by National, and thereafter substantially all Industries' hosiery was dyed and finished at National's plant at In-

The Goodmans sold their stock interests in Real Silk in 1937, and in or about September 1937 they organized Industries at Grenada, Mississippi. An executive committee, appointed by Industries' board of directors, consisted only of J. A. Goodman and L. L. Goodman, and it guided and advised Industries, arranging for the acquisition of facilities by Industries and for the extension of bank credit to Industries.[2] Stevens was placed in charge of Industries' accounting affairs. L. L. Goodman became treasurer of National and supervised all its financial affairs, and J. A. Goodman became president of National and assumed supervision of the manufacturing, dyeing and finishing at National of its own hosiery. During the years involved, Kobin was vice-president and general sales manager of National.

When Solar left Real Silk in the same year, he also became associated with National; he took charge of its purchases of raw materials, and in this connection had close contact with its production activities. In the discharge of his duties at National, he was responsible to J. A. Goodman. In the early part of 1938, Solar paid several visits to Industries' plant at Grenada to advise on difficulties in production which were being experienced. These visits were made at the request of J. A. Goodman. In about May or June 1938, Solar became general manager of Industries, and subsequently, in 1940, he became its president and held that office until about 1945.

Industries' plant was established at Grenada through an arrangement by which that city provided building facilities at a nominal rental, subject to certain minimum requirements as to employment and operations. Industries

[2] This committee appears to have been in existence and still functioning by 1944. Industries returns for its fiscal year ending in 1944 show administrative expense of $4,200.04 attributable to the exceutive committee.

engaged in the manufacturing of hosiery in the grey. It lacked dyeing and finishing facilities, and did not have a sales organization. The machinery with which the plant was equipped was purchased by J. A. and L. L. Goodman and leased by them to Industries. It was a new type of knitting machinery imported from Europe. At that time the common method of manufacture of ladies' hosiery consisted of knitting the leg on one machine, and then transferring the leg to another machine which knitted the foot, resulting in a "double-unit" stocking. The machinery installed at Industries' plant, however, was equipped to knit the entire stocking in one operation on a single machine, producing a "single-unit" stocking. In 1938 Industries began operations experimentally in this new type stocking, working with employees new and inexperienced in the manufacture of this type of hosiery. During this period J. A. Goodman advised Industries respecting the design of this hosiery. Industries did not get into substantial operations until some time in 1938.

Industries' first operations were in silk hosiery, but it later began to work with nylon. However, nylon yarn was not readily obtainable, but the Goodmans, who enjoyed the confidence of the du Pont company which controlled the source of nylon, were able to obtain such yarn for Industries.

The capacity of National's dyeing and finishing facilities exceeded the quantity of its own grey goods production, and National used those facilities to process hosiery in the grey manufactured by other mills. Industries entered into an agreement with National, dated April 12, 1938, for the dyeing and finishing of Industries' hosiery by National, and thereafter substantially all Industries' hosiery was dyed and finished at National's plant at In-

dianapolis. J. A. Goodman and Barskin executed the agreement for National as president and secretary respectively, and J. B. Perry, as president, and E. L. Morrow, as secretary, executed the agreement for Industries. It provided:

* * * * * * * *

(1) Said First Party [Industries] agrees from time to time to ship the incompleted hosiery to the factory of said Second Party [National] at Indianapolis, Indiana.

(2) Said Second Party agrees to process and complete such hosiery in accordance with such instructions as said First Party may from time to time give to said Second Party.

(3) First Party's hosiery when completed and processed shall be held by said Second Party subject to orders of disposition which said First Party shall from time to time deliver to said Second Party.

(4) The charge for said Second Party's services shall be based upon the schedules of charges which said Second Party shall have in effect throughout the term of this agreement, or any renewals thereof.

(5) Second Party shall make no charge whatsoever for storing First Party's hosiery, either complete or incomplete. Title to First Party's hosiery, whole on the premises of said Second Party, shall remain vested in said First Party.

(6) Second Party, at the request of First Party, in addition to processing and completing such hosiery, shall

perform such other services in connection therewith, as said First Party may require, such as boxing, shipping, etc., and said First Party shall pay said Second Party for such additional services any additional cost and expense accruing by reason of such services.

(7) Second Party shall cause First Party's hosiery to be covered by insurance against loss or damage by fire and water, and to be secured by such other types of insurance as said Second Party may deem desirable. Such policies of insurance shall be paid to said First and Second Parties as their interests may appear. Any increase in the cost of Second Party's insurance by reason of this provision shall be borne by said First Party.

(8) All moneys owing to said Second Party by said First Party by reason of any of the terms and conditions enumerated in this agreement shall be payable on or before the 10th day of the month next succeeding that in which said indebtedness was incurred.

• • • • • • • •

The common stock of National (19,450 shares outstanding) and Industries (1,000 shares outstanding), for the periods indicated, was held as follows:

	National		
	7/1/40 to 9/30/41	9/30/41 to 12/31/41	1/2/42 et seq.
J. A. Goodman Family			
Sarah W.	35%	9.18%	9.18%
Robert A. Trust #1		23 %	23 %
Ruth Elaine Trust #1		2.82%	2.82%
	35%	35%	35%

L. L. Goodman Family			
Elliot R. Trust #1	35%	35%	35%
Kobin Family			
Anne Trust	6-2/3%	6-2/3%	9.63%
William Trust	6-2/3%	6-2/3%	9.12%
Florence S.	6-2/3%	6-2/3%	1.23%
	20%	20%	20%
H. V. Kobin	(2 qualifying shares)	(2 qualifying shares)	(2 qualifying shares)
Barskin	10%	10%	10%

Industries

	7/1/40 to 9/30/41	9/30/41 to 12/31/41	1/2/42 et seq.
J. A. Goodman Family			
Sarah W.	35%		
Robert A. Trust #1		18.5%	18.5%
Ruth Elaine Trust #1		14.7%	14.7%
Jacqueline Trust #1		1.8%	1.8%
	35%	35%	35%
L. L. Goodman Family			
Elliott R. Trust #1	35%	35%	35%
Kobin Family			
Anne Trust	6.7%	6.7%	10%
William Trust	6.7%	6.7%	10%
Florence S.	6.6%	6.6%	
	20%	20%	20%
Barskin	10%	10%	10%

Both National and Industries had preferred stock outstanding, which did not appear to play a significant part in the control of either corporation. The preferred stock outstanding, on the dates indicated, was held as follows:

National

	12/31/37	12/31/41
	12/31/38	12/31/42
	12/31/39	12/31/43
	12/31/40	12/31/44
J. A. Goodman Family		
Sarah W.	97-1/2	
Jacqueline Trust #1		97-1/2
L. L. Goodman Family		
L. L. Goodman, Trustee	127-1/2	
Sue Ellen Trust #1		127-1/2
Kobin Family		
Anne Trust	40-1/2	
William Trust	40-1/2	
Florence S.	40-1/2	
Barskin	91-1/2	

Industries

			12/31/41
			12/31/42
		12/31/39	12/31/43
	12/31/38	12/31/40	12/31/44
J. A. Goodmen Family			
J. A. Goodman	185	315	
Sarah W.		345	
Ruth Elaine Trust #1			97
Jacqueline Trust #1			563

L. L. Goodman Family			
L. L. Goodman		30	
Esther M.		65	57
Elliot R. Trust		380	
Sue Ellen Trust #1			418
Dorothy G. Adler	90	90	90

Grenada Knitting Mills, Inc. (hereinafter referred to as "Knitting"), was a corporation organized under Indiana law in or about March 1938. The Goodmans participated in the organization of Knitting. Knitting employed both J. A. and L. L. Goodman, and the Goodmans held executive office in Knitting and were responsible for its management. On September 8, 1939, Knitting had 100 shares of stock outstanding, which had been issued as follows: 35 shares to the wife of J. A. Goodman; 35 shares to a trust for L. L. Goodman's son (Elliot R. Goodman Trust No. 1); 6-2/3 shares to each of the trusts for Kobin's two children (Anne Kobin Trust and William Kobin Trust), and 6-2/3 shares to Kobin's wife; and 10 shares to Barskin.

Knitting did not at any time have any machinery, mill, finishing plant, or any production facilities whatever; nor did it have a sales force. It had no inventory, nor did it at any time purchase or acquire any hosiery for resale, or otherwise. It had no officers or employees who were not also officers or employees of Industries or National. By oral agreement, some time prior to June 30, 1940, the Goodmans, representing Knitting, undertook to furnish to Industries their ideas as to merchandising, styling and design of the hosiery to be made by Industries. They also undertook to find a market for Industries' hosiery, as finished and dyed by National; such market consisted of several large purchasers, such as Sears, Roe-

buck and Company, procured directly by the Goodmans, as well as a larger number of smaller purchasers who were obtained by National's sales organization. Industries was to receive only the fair market price for its hosiery in the grey (plus reimbursement for any finishing or dyeing charges that it may have paid to National). Knitting was to be compensated by retaining what was left from the full price paid by the ultimate purchasers of the finished product, after subtracting the price for the hosiery in the grey which Knitting transmitted to Industries and after subtracting also the costs of dyeing, finishing, and selling which were paid to National. Title to the hosiery remained in Industries at all times until it passed to the purchaser. Neither Knitting nor National purchased the hosiery from Industries. Knitting did not guarantee that it would furnish a market for Industries' products or undertake to assure Industries of any profit or return on Industries' products, but it was anticipated that the "know-how" of the Goodmans, acting for Knitting, would result in a market for Industries' products and that Industries could reasonably count upon receiving a fair price for its hosiery. In connection with making available National's sales organization to sell Industries' finished products to the trade, Knitting entered into a written agreement with National dated January 14, 1939. The agreement was signed for National by J. A. Goodman as president and by Barskin as secretary, and for Knitting by George P. Dovle as president and Samuel J. Mantel as secretary. Mantel was a lawyer who represented the Goodmans at various times. The agreement provided:

* * * * * * *

Whereas, the parties hereto have found it to be more economical to have one group of salesmen engaged in

selling the products of the parties hereto, rather than having separate groups sell such products; and

Whereas, it is to the mutual interests of the parties hereto that purchasers of the products of said parties receive one billing for the merchandise so purchased; and

Whereas, said First Party [National] has no interest of any nature whatsoever in the proceeds of the sales of Second Party's [Knitting's] merchandise, and Second Party has no interest whatsoever in the proceeds of the sales of First Party's merchandise;

Now, therefore, in consideration of the sum of One Dollar paid by each of the parties hereto to the other and other valuable considerations, receipt of which is hereby acknowledged, and in the further consideration of the covenants and promises hereinafter set out, it is agreed as follows:

(1) All merchandise sold by salesmen who may jointly represent the First and Second Parties hereto shall be billed by the party in whose name such order is placed.

(2) All expenses incident to the filling of such orders shall be prorated between the parties hereto in accordance with the expense incident to the shipping of such party's merchandise.

(3) The party receiving any remittance in payment of any such merchandise so billed shall hold that part of such remittance(s) representing payment of the merchandise of the other party in trust, and within 10 days of the receipt of such remittance(s) shall deliver such trust receipts to the other party.

(4) In the event it shall become necessary to institute any legal action for the collection of any of the accounts, then in such event that party in whose name such merchandise has been billed shall institute such legal actions and prosecute same to their termination. The expense of such legal actions shall be prorated between the parties hereto in accordance with their financial interest in the accounts involved.

(5) In the event that any buyers may make claims against either of the parties hereto by reason of defects in the merchandise shipped, or otherwise, no adjustment shall be made except with the consent of that party whose merchandise is involved.

(6) Any and all expense of any nature whatsoever incurred by either of the parties hereto by reason of this agreement, or any of the terms and conditions herein enumerated, shall be prorated in accordance with the actual interest of the parties hereto.

* * * * * * * *

Although the foregoing agreement purported to deal with products belonging to National and Knitting, such was not the fact: Knitting had no products; the products attributed to Knitting belonged to Industries, and the agreement in fact dealt with the products of National and Industries. It was only the oral agreement between Industries and Knitting, mentioned above, that furnished the basis for Knitting's entering into the written agreement with National.

Such business activity as Knitting carried on was discontinued on or about June 30, 1940, although Knitting

was not dissolved. It was succeeded in that activity by Grenada Hosiery Mills (hereinafter referred to as "Hosiery"). Hosiery was organized as a partnership, under Indiana law, pursuant to articles of partnership dated July 1, 1940. Knitting was replaced by Hosiery because it was believed that Knitting's small capital put it at a disadvantage under the excess profits tax, applicable to corporations, adopted in 1940. Knitting assigned to Hosiery its interest in the written agreement of January 14, 1939, between National and Knitting; National consented to the assignment, and Hosiery agreed to comply with the terms and conditions of the agreement.

The Goodmans participated in the decision to replace Knitting by Hosiery, as did Stevens. The Goodmans and Kobin were not partners of record in Hosiery, just as they had not been stockholders of record in Knitting. But the Hosiery partnership agreement was executed by J. A. Goodman as trustee for the son of L. L. Goodman (Elliot Goodman Trust No. 2); Barskin as trustee for a daughter of J. A. Goodman (Jacqueline Goodman Trust No. 2); Kobin as trustee for his children (Anne Kobin Trust and William Kobin Trust), and as attorney-in-fact for his wife; and Barskin as an individual.

The partnership interests in Hosiery, for the periods indicated, were as follows:

	7/1/40 to 9/30/41	9/30/41 to 12/31/41	1/2/42 to 7/17/43	7/17/43 et seq.
J. A. Goodman Family				
Jacqueline Trust #2	35%	35%	35%	31.82%
L. L. Goodman Family				
Elliot R. Trust #2	35%	35%	35%	31.82%

Kobin Family				
Anne Trust	6-2/3%	6-2/3%	6-2/3%	6.06%
William Trust	6-2/3%	6-2/3%	6-2/3%	6.06%
Florence S.	6-2/3%	6-2/3%	6-2/3%	6.06%
	20%	20%	20%	18.18%
Barskin	10%	10%	10%	9.09%
Solar Family				
Ronia L. (wife of Israel E. Solar)				9.09%

The Hosiery partnership agreement provided:

* * * * * * * *

(4) By reason of the fact that A. J. Barskin is a partner in such Grenada Hosiery Mills, and is Trustee for the Jacqueline Goodman Trust, owner of an interest in such partnership, and in order to avoid any conflict of interest which may arise, A. J. Barskin hereby designates and appoints L. L. Goodman as representative (for the purpose of this agreement only) of the interest of said Jacqueline Goodman Trust.

(5) All checks, notes and other evidences of indebtedness pertaining to the partnership may be executed for and on behalf of said partnership, by J. A. Goodman, L. L. Goodman, H. V. Kobin and A. J. Barskin, or by any nominee or designee which any of them may name in writing. The salaries to be paid to any partner or employee of said partnership shall be based upon services rendered to said partnership and contribution to the administration and success of the business and shall be in such amounts as may from time to time be determined by said partners.

(6) All expenses pertaining to the operation of said partnership shall be borne, paid and discharged by the parties hereto in the following ratio: By the First Party [J. A. Goodman, as trustee] 35%; by the Second party [Barskin, as trustee] 25%; by the Third Party [Kobin, as trustee and attorney] 20%; and by the Fourth Party [Barskin] 10%; and all gains, profits and increases that shall come or arise from or by means of such partnership business shall accrue to the parties hereto in such percentages, and all losses resulting from depreciation, bad debts or otherwise, shall be borne and paid by the parties hereto, in accordance with such percentages.

* * * * * * * *

(13) The business policy of this partnership shall be determined by J. A. Goodman, Trustee, L. L. Goodman, H. V. Kobin, Trustee, and A. J. Barskin, each of whom shall have as many votes as the percentage of interest owned by him bears to the total interests of all partners. The majority (based on percentage) shall prevail. * * *

* * * * * * * *

Paragraph 13 of the Hosiery partnership agreement was amended to read as follows by a written agreement dated September 22, 1941:

(13) The business policy of this partnership shall be determined by J. A. Goodman, L. L. Goodman, H. V. Kobin and A. J. Barskin, who shall be designated as "Policy Makers." In determining such business policy J. A. Goodman shall have 35 votes; L. L. Goodman shall have 35 votes; H. V. Kobin shall have 20 votes; and A. J. Barskin shall have 10 votes. The majority (based on percentage) of all votes shall prevail. * * *

The Parties hereto agree that the management of the business affairs of this partnership requires the services of those experienced in the business to be engaged in by this partnership. Accordingly, it is agreed that in the event any of the parties hereto shall dispose of his interest in this partnership, the assignee of such interest shall not be entitled to have a voice in the business policy of this partnership nor shall any heir, executor, administrator, successor, or assign, have any right to participate in the determination of the business policy of this partnership unless and until the Policy Makers then retaining voting power shall consent thereto in writing.

By a written agreement dated July 17, 1943, Ronia L. Solar, wife of Solar, was formally made a partner in Hosiery to the extent of a 9.09 per cent interest, and the interests of the other partners were proportionately modified.

Capital was not a factor in the operation of either Knitting or Hosiery. Hosiery's capital at its organization consisted of $4,286.25 in notes receivable contributed for or by its partners. Two of these notes, for $1,500 each, were issued by J. A. and L. L. Goodman and were given by them to the respective trusts for their children which became partners of record in Hosiery. No cash was included in the original investment in Hosiery. On or about May 17, 1941, these notes were paid by their makers in the face amount, $4,286.25. On or about the same date, May 17, 1941, the partners withdrew cash from Hosiery in the total amount of $25,000, the withdrawal of each partnership being proportionate to his respective partnership interest.

As in the case of Knitting, Hosiery did not at any time own, lease, or use any machinery, mill, finishing plant, or

production facilities; it had no inventory nor did it at any time purchase or acquire any hosiery for resale, or otherwise; it had no sales force, but both Knitting and Hosiery relied upon National's sales organization, which was supervised by Kobin, to sell hosiery manufactured and owned by Industries. Hosiery's business address, as reported on its partnership tax returns, was the same as that of National. There were no persons employed by either Knitting or Hosiery who were not also employed by Industries or National. Both Knitting and Hosiery were dependent on the services of the Goodmans and Kobin, who continued to serve Hosiery as they had Knitting.

A written agreement was entered into between Hosiery and Industries dated June 24, 1940. In making this agreement, Industries was represented by Solar, and Hosiery was represented by the Goodmans. The agreement provided:

* * * * * * * *

Whereas, Industries maintains a plant in the City of Grenada, County of Grenada, State of Mississippi, in which it partially manufactures hosiery up to the stage in process known as "in the greige"; and

Whereas, Mills [Hosiery] is a partnership thoroughly competent in all phases of the sale, manufacture and merchandising of hosiery; and

Whereas, Industries does not wish to create its own sales organization and merchandising plan, and does not have the facilities for finishing its hosiery.

* * * * * * * *

Article I.

Industries will manufacture hosiery to the stage of process known as "in the greige" to the standards and specifications recommended by Mills.

Article II.

Mills will supervise the finishing, merchandising and sale of such hosiery either by developing the facilities for so doing, or by engaging facilities for the purpose. However, Mills shall not engage or enter into any contract for such facilities unless the terms and conditions of such engagement, and/or, contracts have been approved by Industries.

Article III.

When Mills engages or contracts with other facilities for the purpose of finishing or merchandising, the expense thereof, may, at the discretion of Mills, be charged either directly to Industries by such facilities, or paid for by Mills, in the latter of which event, Industries shall reimburse Mills for such expense. In either event, such expense shall be added to the "cost of sales" of Industries, as hereinafter defined.

Article IV.

Any expense incurred in connection with the sale of the products of Industries, shall be borne by Mills and if incurred by Industries, shall be charged to Mills and shall be deducted by Mills from proceeds of sales in arriving at "net sales proceeds" as hereinafter defined.

Article V.

Mills agrees to make available immediately to Industries upon request, the entire proceeds of sales of Industries' products which Mills receives, less such disbursements as Mills may make in connection with the expense incidental thereto, (including such payments as Mills makes to Industries in payment of charges incurred under Article IV hereunder), or such other expense as Mills may incur for the account of Industries in connection with merchandising and finishing. It is agreed by both parties that Mills does not, by so doing, surrender its right to compensation as hereinafter set forth.

Article VI.

For the supervision of the finishing, merchandising and sale of Industries' products, Mills shall be compensated for its services in the manner set forth in this agreement and according to the following formula:

(A) To the cost of manufacturing, including administration costs, and all costs incidental to the operating of its business, Industries shall add such charges as have been made by Mills under Article III of this agreement and shall thereby arrive at a "cost of sales".

(B) From the gross proceeds of sales of Industries' products, Mills shall deduct such trade discounts as have been granted to customers, and such losses as have been sustained by "bad debts", and the expense involved in selling the products of Industries, and shall thereby arrive at a "net sales proceeds".

(C) In the event that Industries' "Cost of sales" are equal to or in excess of Mills' "net sales proceeds" then

Industries shall bill Mills for the full amount of Mills' "net sales proceeds" according to Mills' books and Mills shall receive no compensation for its services.

(D) In the event Industries' "cost of sales", as heretofore described, are less than Mills' "net sales proceeds", then a computation shall be made of the difference between the two for the purpose of determining the proportion that is

1. Attributable to efficiency in greige manufacturing, or other operations performed and/or supervised by Indutries.

2. Attributable to low cost and efficient finishing as supervised by Mills.

3. Attributable to a fair and reasonable estimate of the value of any merchandising plans that have, or shall have been developed by Mills.

4. Attributable to efficient selling as supervised by Mills.

(E) Industries shall forthwith bill Mills for its "cost of sales" as described in Paragraph A of this Article, plus the amount that has been allocated as attributable to efficiency in greige manufacturing, or other operations performed and/or supervised by Industries, as described in Paragraph D-1, and the balance between this amount and Mills' "net sales proceeds" shall be accrued on the books of Industries to the benefit of Mills, and shall, upon request, be paid to Mills.

Article VII.

For the purpose of making the computation in Article VI, paragraph D, Mills shall be represented by Mr. L. L. Goodman, or in the event of his failure or inability to serve, Mr. J. A. Goodman, Mr. H. V. Kobin, and Mr. A. J. Barskin, in the order named, and Industries shall be represented by Mr. I. E. Solar, or in the event of his failure or inability to serve, by Mr. Samuel J. Mantel, and Mr. J. B. Perry, Jr., in the order named.

Article VIII.

In the event that the representatives of each of the parties shall fail to come to an agreement acceptable to both of them, then they shall select a third party, mutually agreeable to both of them, as arbitrator, and his decision shall be final and binding on both parties.

Article IX.

Nothing in this agreement shall exclude Industries, at any time, from making such provisions as it may decide to make for finishing or selling its own products, but Industries agrees that the merchandising rights shall be exclusively granted to Mills for the term of this agreement.

Article X.

The computation described in Article VI, Paragraph D, shall be made at least once annually as of the close of business of the fiscal year of Mills, but can be made more often, if convenient and agreeable to both parties.

Article XI.

This agreement shall expire on the 30th day of June, 1945.

* * * * * * * *

The Industries-National agreement did not fix specific charges for the services to be performed by National, but left the charges to be worked out in the future according to such criteria as were mentioned in the provisions quoted from the agreement. Periodically the amounts owed by Industries to National were settled by agreement between them, and in the settlement of these amounts Industries was represented by Solar and National was represented by L. L. Goodman and Kobin. On occasion, J. A. Goodman also participated in the settlement of these amounts.

While the National-Knitting agreement, later taken over by Hosiery, provided that expenses incident to filling of orders should be prorated between the parties, it did not describe the expenses with any particularity and was ambiguous as to the manner in which proration was to be made. When there was any question as to allocation of such expenses, the matter was submitted to Stevens. Usually, however, there was no dispute. The amounts which were allocated to Hosiery are evidenced by Hosiery's partnership returns. Those returns, for the fiscal periods 1942-1943 and 1943-1944 respectively, report "other deductions" of $72,264.53 and $42,302.88, and these sums are explained on the returns as including sales expense billed by National in the amounts of $70,764.46 and $40,691.14 for those respective periods. "Other deductions" were reported in the returns for 1940-1941

and 1941-1942, without breakdown, in the respective amounts of $112,028.98 and $122,595.64.

The Industries-Hosiery agreement, in providing for the division of proceeds derived from the sale of the finished product, used such flexible terms as "efficiency in greige manufacturing", "low cost and efficient finishing as supervised by Mills", "efficient selling as supervised by Mills", and "a fair and reasonable estimate of the value of any merchandising plans * * * developed by Mills". Such terms remained to be interpreted, and in the settlement between the parties their interpretation and specific application was left to Stevens, who was given a free hand in this regard although he might consult with such persons as L. L. Goodman and Kobin. In practice, an agreement was always reached as to the amounts to be paid Industries.

The relationships between Industries, Hosiery, and National developed as follows: Industries manufactured hosiery in the grey and shipped it to National for dyeing and finishing. The hosiery finished by National for Industries was kept by National separately from National's own hosiery. Except for the few large customers obtained directly by the Goodmans and Kobin, the Industries hosiery was sold by National's sales organization and by the same salesmen who sold National's hosiery. Customers were invoiced by National and usually in National's name, but some invoices were made out in Hosiery's name. Some customers made payment to Hosiery; others paid National. National deducted from the proceeds it received a charge for the use of its sales force, including therein an allocated portion of its sales expenses and an amount for a reasonable profit, and remitted the balance to Hosiery. National's charge for finishing and dyeing, consisting of the costs of finishing

and dyeing plus a reasonable profit, was paid by Industries. Notwithstanding the provisions of Article VI of the agreement of June 24, 1940, Industries "billed" Hosiery for the hosiery in the grey, its charge consisting of an amount representing the fair market price for hosiery in the grey but in no event an amount less than the total costs of Industries attributable to production of the hosiery in the grey, plus the cost to it of dyeing and finishing the hosiery at National, plus such other charges as Industries might incur after the point of manufacture. The amount so "billed" was remitted to Industries by Hosiery out of the sales proceeds received from National, and the balance was retained by Hosiery as its "profit" or "compensation". There were inter-company accounts between Hosiery and Industries, and when remittance by check was received by Hosiery from National, Hosiery in turn might indorse the check to Industries in liquidation of those accounts.

Although the hosiery in the grey was "billed" by Industries to Hosiery, and although there was reference in the evidence to the "price" paid by Hosiery for the hosiery and the "cost" to Hosiery of goods sold, Industries retained title to the hosiery when finished, and in fact, Hosiery never purchased or acquired any hosiery from Industries. The hosiery involved belonged to Industries, and was sold to the trade by National's sales organization, except in the case of several large purchasers (such as Sears, Roebuck & Co.) who dealt directly with the Goodman or Kobin, purporting to represent Hosiery. But even in the latter situation it was Industries' hosiery that was being sold. The only other function performed by Hosiery in relation to the Industries' product was to provide styling and "merchandising" services.

L. L. Goodman, J. A. Goodman, and Kobin, during the tax years here involved, rendered valuable services in the styling, merchandising, marketing and selling of the hosiery produced by Industries. In rendering these services, the Goodmans and Kobin were acting as employees of Hosiery, and Hosiery provided these services to Industries. No other employees of Hosiery, if there were any, rendered any services of consequence in relation to Industries' product, nor did the partners of Hosiery render any such services.

Generally, a good price is available for hosiery in the grey when the market is strong, but such hosiery promptly feels the effect of a weakening in the market. When the demand for hosiery is weak, the seller of hosiery in the grey is at a disadvantage because of the lack of a brand name to support its selling power. Branded hosiery is better able to retain a market and maintain its prices. The services of the Goodmans and Kobin established brand names and a market for Industries' hosiery, assuring Industries of steady operation and the sale of its product in the finished market at the best prices, thereby reducing the insecurity and uncertainty otherwise attending the manufacture and sale of hosiery in the grey. The Goodmans and Kobin supervised the merchandising aspects of the manufacturing, dyeing and finishing operations so as to create products which most appealed to the public; they styled and designed the hosiery, and were responsible for features being incorporated in the course of these operations which attracted the public; and they introduced and supervised sales ideas and programs which provided wide distribution for the finished hosiery. This was particularly important in view of the novelty of the single-unit type hosiery Industries undertook to manufacture, the quality and worth of which had to be

proven to the trade and a market for which had to be created.

During the tax years in question, the Goodmans and Kobin received salaries paid by Hosiery. The amounts of the salaries paid them by Hosiery were established with their agreement, and they took part in deciding what those amounts would be. The amounts so decided upon were considered fair salaries. For the fiscal year ended June 30, 1941, the partnership return of Hosiery disclosed salaries and wages in the aggregate amount of $82,908.44, substantially all of which was paid to the Goodmans and Kobin. The aggregate wages and salaries similarly paid by Hosiery for the succeeding fiscal years ending June 30, were as follows: 1942, $20,000; 1943, $8,151.29; 1944, $8,320.

During the years involved there were in the United States independent experts in the hosiery industry who provided merchandising and styling services for fees ranging from $10,000 to $25,000 a year.

Waste is a common by-product of the manufacture and processing of hosiery. Salvage of such waste in the manner earlier described is one of the phases of the hosiery industry. Ordinarily an individual mill does not have enough waste to justify organizing a salvage department. Most mills do not have their own salvage department, although Real Silk did have such a department.

Neither Industries nor National had such a department, and up to 1942 they sold their waste to dealers. By that time, however, nylon yarn, which had come into use in the manufacture of hosiery, was very scarce, and salvage operations therefore became increasingly important. In January 1942, Abar Process Company (hereinafter re-

ferred to as "Abar") was formed, as a partnership under Indiana law, to engage in the salvage of hosiery waste. The Goodmans and Kobin were instrumental in the formation of Abar, and Barskin, who was then associated with National, also became the operating head of Abar. The partners of record in Abar at the time of its formation were the two Goodmans, Kobin's wife and Barskin. They executed a partnership agreement dated January 2, 1942, which provided:

This Indenture entered into this 2nd day of January, 1942, Witnesseth An Agreement by and between J. A. Goodman, hereinafter referred to as First Party, L. L. Goodman, hereinafter referred to as Second Party, Florence S. Kobin, hereinafter referred to as Third Party, and A. J. Barskin, hereinafter referred to as Fourth Party, all of Indianapolis, Marion County, Indiana.

* * * * * * * *

(3) The initial capital of this partnership shall be $1,000.00, of which the First and Second Parties agree to contribute $350.00 each, the Third Party $200.00, and the Fourth Party $100.00. Should further capital be required for carrying on the business, such additional capital shall be advanced by the partners in the above ratio. * * *.

(4) All checks, notes, and other evidence of indebtedness pertaining to the partnership may be executed, for and on behalf of said partnership, by J. A. Goodman, L. L. Goodman, A. J. Barskin, and H. V. Kobin, whom Florence S. Kobin has designated as her attorney-in-fact for such purpose, or by any nominee or designee which any of the foregoing may name in writing. The salaries to

be paid to any partner or employee of said partnership shall be based upon services rendered to said partnership and contribution to the administration and success of the business, and shall be in such amounts as may from time to time be determined by said partners.

(5) All expenses pertaining to the operation of said partnership shall be borne, paid and discharged by the parties hereto in the following ratio: By the First Party 35%; by the Second Party 35%; by the Third Party 20%; and by the Fourth Party 10%; and all gains, profits and increases that shall come or arise from or by means of such partnership business shall accrue to the parties hereto in such percentages, and all losses resulting from depreciation, bad debts or otherwise, shall be borne and paid by the parties hereto, in accordance with such percentages.

* * * * * * * *

(11) The First Party and the Second Party are each creating trusts and contemplate assigning to such trusts their respective interests in and to this partnership. Each of the partners hereby consent to such assignments upon the condition that the provisions of this partnership agreement shall be binding upon the trustees of such trusts, and upon the further provision that any distribution by the Trustees of such trusts shall, for the purpose of this agreement, be considered as a sale of a partnership interest, and shall be subject to the terms and conditions herein set out and pertaining to the sale of any partnership interest.

(12) The business policy of this partnership shall be determined by J. A. Goodman, L. L. Goodman, H. V.

Kobin, as Attorney-in-Fact for Florence S. Kobin, and A. J. Barskin. In detemining such policy J. A. Goodman and L. L. Goodman shall each have 35 votes; H. V. Kobin 20 votes; and A. J. Barskin 10 votes. The majority vote shall prevail. * * *.

It is the sense of this agreement that the business policy of this partnership shall be determined by those above designated, subject to the terms and conditions hereinabove set out, and that no heir, executor, administrator, successor, beneficiary, or assign shall have any right to participate in the determination of such policy unless and until those who still retain voting power shall in writing consent thereto.

* * * * * * * *

Subsequently, Ronia Solar was made a partner of record in Abar to the extent of a 9.09 per cent interest by an agreement dated October 9, 1943, and the interests of the other partners were changed proportionately.

The interests of the partners of record in Abar, for the periods indicated, were as follows:

	1/2/42 to 10/9/43	10/9/43 et seq.
J. A. Goodman Family		
Jacqueline Trust #5	35%	31.82%
L. L. Goodman Family		
Elliot R. Trust #4	35%	31.82%
Kobin Family		
Anne Trust	6-2/3%	6.06%
William Trust	6-2/3%	6.06%

Florence S.	6-2/3%	6.06%
	20%	18.18%
Barskin	10%	9.09%
Solar Family		
Ronia L.		9.09%

Abar's machinery consisted essentially of several old coning machines formerly used by National and Fulton Hosiery Mills (hereinafter referred to as "Fulton"), adjusted to unravel and rewind yarn according to a method invented by Barskin. Fulton had been organized by the Goodmans who, by 1937, transferred their Fulton interests to their wives or to certain of the trusts for their children. Abar either did not acquire or did not retain ownership of the machines so used by it. Depreciation does not appear as a claimed deduction on the tax returns of Abar introduced in evidence.

After Abar was organized, Industries and National sold their waste to Abar, and purchased reclaimed yarn from Abar. The prices paid to and by Abar in these transactions were the established market prices. Abar also purchased waste from other sources, and, during the scarcity in materials, bought waste wherever it could be found. While Abar sold reclaimed yarn to other buyers, most of its sales of yarn were made to Industries, National and Fulton. Defective hosiery purchased by Abar was mended by it and was finished by National, and then was sold by Abar to jobbers. National's charge to Abar for finishing this hosiery was at the prevailing market price.

During the tax years here in issue, separate books of account were kept for Industries, National, Hosiery and

Abar. Preparation and maintenance of their accounting records and reports were all under the control and supervision of Stevens at Indianapolis. The books of National, Hosiery and Abar were kept at Indianapolis; the general ledgers of Industries were kept at Indianapolis and its subsidiary records, which were usually kept in Mississippi, at times were sent to Indianapolis. The tax returns of all these companies, including the returns of Industries, were prepared at Indianapolis under Stevens' direction. Stevens also prepared the Goodmans' tax returns, and advised the Goodmans and Kobin as to arrangement of their business affairs so as to incur the minimum taxes. The returns for the trusts created by them were also prepared by Stevens.

From at least July 1, 1940, to the last half of 1943, the J. A. Goodman, L. L. Goodman, and Kobin families and Barskin were the record owners of all the common stock of Industries and National, substantially all the preferred stock of Industries and National, and the entire partnership interests in Hosiery and Abar. During this period, the proportionate interests of the J. A. Goodman, the L. L. Goodman, the Kobin families, and Barskin were, with insignificant variation, identical in the common stock of Industries, the common stock of National, and in the Hosiery and Abar partnerships. These proportionate interests were as follows: J. A. Goodman family—35 per cent; L. L. Goodman family—35 per cent; Kobin family—20 per cent; Barskin—10 per cent.

These interests in the common stock of Industries and National continued unchanged during 1943 and throughout the remainder of the tax years here in issue. By a written agreement dated July 17, 1943, Solar's wife, Ronia, was admitted to a 9.09 per cent interest of record

in Hosiery, and by a written agreement dated October 9, 1943, she was also admitted to a 9.09 per cent record interest in Abar. The other record interests in both Hosiery and Abar were then adjusted accordingly to the following: J. A. Goodman family—31.82 per cent; L. L. Goodman family—31.82 per cent; Kobin family—18.18 per cent; Barskin—9.09 per cent.

The interests of the J. A. Goodman, L. L. Goodman, and Kobin families were held, as record owners, in the names of their wives or the trusts for their children. But those family interests were in fact owned or controlled directly or indirectly by J. A. Goodman, L. L. Goodman, and Kobin respectively. Similarly, when Ronia Solar was made a record partner in Hosiery and Abar, the interests ascribed to her were in fact owned or controlled directly or indirectly by her husband, Israel E. Solar. Thus, although Kobin's wife and the trusts for his two children were the record holders of an aggregate 20 per cent interest in National's common stock, the true situation was reflected in National's income tax returns for 1940 and 1942, which state that Kobin owned 20 per cent of the common stock of National.

The ultimate control over the management and operation of Industries, National, Hosiery and Abar, was exercised by J. A. Goodman, L. L. Goodman, Kobin and Barskin.

None of the Goodman and Kobin children, whose trusts were record owners of interests in these businesses, ever had any experience or training in the hosiery industry, or took any part in the business affairs of Industries, National, Hosiery or Abar. There is no evidence that the Goodman, Kobin or Solar wives had any such ex-

perience or training or participated in the affairs of these businesses. The Goodmans and Kobin originally were the trustees under some of the trusts they set up for their children; by the end of 1942, Stevens was the sole trustee under all these trusts for the Goodman and Kobin children. Control of the accounting and tax affairs of all these businesses as well as the trusts for the children was concentrated in Stevens.

Hosiery's "Gross receipts from business or profession" and its "net" income as reported on its returns, and its "net" income as adjusted by respondent, were as follows:

Year Ended June 30	Gross receipts from business or profession	Net Income	Net Income As Adjusted
1941	$1,933,429.92	$101,928.57	$103,486.30
1942	1,628,582.38	2,533.17	4,033.24
1943	1,203,672.35	48,415.96	49,916.38
1944	1,585,425.38	55,473.38	55,473.38

These reports of gross receipts consisted largely, if not entirely, of the receipts from the sales of Industries' hosiery, and belong to Industries rather than to Hosiery. It was thus necessary, in computing net income on Hosiery's returns, to subtract large amounts each year ($1,631,293.46 for 1941, $1,478,748.81 for 1942, $1,071,262.49 for 1943, and $1,492,153.36 for 1944) as the cost of "merchandise bought for sale", notwithstanding the fact that Hosiery did not buy any goods for sale, and therefore had no such costs.

Abar reported the following net income in its returns:

Tax Period	Net Income
1/2/42—9/30/42	$10,210.33
10/1/42—9/30/43	20,140.29
10/1/43—9/30/44	14,423.75

Respondent attributed to Hosiery an annual allowance of 10 per cent on a capital of $4,286.25, amounting to $428.63, plus $1,000 as salary for Barskin. Respondent attributed to Abar an annual allowance of $1,000 on a capital of $1,000, plus a salary of $1,000 for Barskin. The remainder of Hosiery's adjusted income and Abar's reported income were allocated to Industries and National in the following amounts:

Allocated to Industries

Year Ended March 31	From Hosiery	From Abar
1941	$62,068.57	$ .....
1942	29,164.11	116.14
1943	30,189.53	338.85
1944	45,893.73	547.70

Allocated to National

Year	From Hosiery	From Abar
1940	$3,819.94	$.....
1941	6,329.43	.....
1942	4,581.77	12,335.43
1943	5,394.33	16,071.71

The notices of deficiency sent to petitioners each stated:

> Pursuant to the provisions of section 45 of the Internal Revenue Code portions of the gross income attributed to "Grenada Hosiery Mills", a purported partnership, have been allocated to you and included in your net income for the taxable years and in the amounts set forth below, to-wit:
>
> * * * * * * * *
>
> In the alternative it is held that said purported partnership is without substance and that said portions of the income which were attributed to said purported partnership are taxable to you under the provisions of section 22(a) of the Internal Revenue Code.

Each notice of deficiency also made the same statement respecting the allocations of Abar's income to petitioners.

The notices of deficiency did not show the method of allocation of Hosiery's and Abar's income. There were introduced in evidence, however, a revenue agent's reports on Industries and on National. The amounts allocated to them by respondent were identical with the allocations made of Hosiery's and Abar's income in these reports, and these reports show the computations by which these allocations were reached.

National, Industries, Hosiery and Abar were separately existing and functioning organizations, trades or businesses, but were owned or controlled directly or indirectly by the same interests. Allocation of Abar's income to petitioners was arbitrary and unreasonable, and such allocation was not necessary to prevent evasion of taxes

or clearly to reflect petitioners' income. Allocation of Hosiery's income to National was likewise arbitrary and unreasonable. But respondent's allocation of Hosiery's income to Industries was reasonable and was necessary to prevent evasion of taxes or clearly to reflect Industries' income. The value of the services rendered by Hosiery to Industries was no greater than the salaries and wages paid by Hosiery during each of the years involved.

OPINION.

RAUM, Judge:

1. At the outset, we dispose of respondent's contention that the asserted deficiencies are supported by Section 22(a) of the Internal Revenue Code. Throughout the argument based upon Section 22(a) there is implicit the suggestion that the entities of Hosiery and Abar should be disregarded and that their income be attributed to Industries and National. We cannot accept that position.

Hosiery and Abar were functioning entities. Each in fact rendered valuable services. True, all four organizations were actually controlled by the same persons, and neither Hosiery nor Abar had any employees who were not also officers or employees of Industries or National, so that all of the functions discharged by Hosiery and Abar could have been performed just as readily by Industries and National. But the fact is that Hosiery and Abar were valid partnerships, and they actually did play real parts in the hosiery business. Hosiery did furnish styling and merchandising services to Industries; Abar did engage in the business of salvaging defective hosiery. There is no basis, upon this record, for disregarding the organizational entities of Hosiery and Abar. Cf. Chelsea Products, Inc., 16 T. C. 840; Estate of Julius

I. Byrne, 16 T. C. ...; Seminole Flavor Co., 4 T. C. 1215, 1234-1235.

The income actually earned by Hosiery and Abar may not be attributed to Industries or National under Section 22(a). This does not mean, however, that either Industries or National was at liberty, tax-wise, to deflect to Hosiery or Abar any portion of the income really earned by Industries or National. In such circumstances the general provisions of Section 22(a) are undoubtedly sufficient to charge the income to the one that actually earned it. Cf., e. g., Lucas v. Earl, 281 U. S. 111; Griffiths v. Commissioner, 308 U. S. 355; Helvering v. Eubank, 311 U. S. 122; Commissioner v. Sunnen, 333 U. S. 591; Lyman A. Stanton, 14 T. C. 217, affirmed, ... F. 2d ... (C. A. 7, May 15, 1951). But in the case of organizations under common control, the detailed provisions of Section 45 of the Code[3] explicitly authorize the Commissioner to unscramble any such situation, so that income may be charged to the organization that earned it. Thus, to the extent that Section 45 may be applicable, Section 22(a)

[3] SEC. 45. ALLOCATION OF INCOME AND DEDUCTIONS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

Section 45 was amended by Section 128 of the Revenue Act of 1943 (c. 63, 58 Stat. 21) as follows:

Section 128(b). Technical Amendment.—Section 45 (relating to allocation of income and deductions) is amended by striking out "gross income or deductions" and inserting in lieu thereof "gross income, deductions, credits, or allowances."

Section 128(c). Taxable Years To Which Applicable.—The amendments made by this section shall be effective with respect to taxable years beginning after December 31, 1943. The determination of the law applicable to prior taxable years shall be made as if this section had not been enacted and without inferences drawn from the fact that the amendment made by this section is not expressly made applicable to prior taxable years.

adds nothing to the strength of respondent's position here. We pass, therefore, to a consideration of Section 45.

2. That all four organizations were "owned or controlled directly or indirectly by the same interests" within the meaning of Section 45 is abundantly clear on this record. All four organizations were dominated primarily by the two Goodmans, and to a lesser degree by Kobin and Barskin. We are satisfied that Solar and Stevens were subservient to the wishes of the Goodmans and Kobin.[4]

It is immaterial that the record ownership of the various stock and partnership interests may not have been in the identical persons or trusts at the same times. Throughout the years in question the J. A. Goodman family owned 35 per cent, the L. L. Goodman family 35 per cent, the Kobin family 20 per cent, and Barskin 10 per cent of the common stock of Industries and National. The same percentage interests were applicable to both partnerships, Hosiery and Abar, until 1943, when they were changed slightly (but in the same proportion) so as to admit Solar's wife as a record partner with a 9.09 per cent interest—an event which in no way affected the control or management of either enterprise. Although it is true

[4] In an attempt to show Solar's independence, petitioners presented testimony that in one instance Solar vigorously complained about the repairing of certain of Industries' defective hosiery by National at Indianapolis rather than returning the hosiery to Grenada where it could have been repaired at lower cost by non-union labor. That incident surely does not establish or even indicate that Solar was not at all times subject to the complete domination of the Goodmans and Kobin. For, if Solar were correct in his contention that the repairing of the defective hosiery in Indianapolis resulted in higher costs, it is only too clear that the Goodmans and Kobin, as well as Barskin, would have acquiesced in his position. He was sponsoring a position that was in their interest, and it would strain our credulity to suggest that Solar would have persisted in any course of action contrary to the considered judgment of the Goodmans and Kobin and antagonistic to the interests which they were protecting.

that the record ownership of the stock or partnership interests may not have been in the same persons or the same family trusts, the fact is that the 35-35-20-10 ratio (representing the proportionate interests of the Goodman and Kobin families and Barskin in relation to each other) was at all times maintained and that the actual control at all times material, represented by those interests, was really exercised by J. A. Goodman, L. L. Goodman, Kobin and Barskin.

Section 45 speaks in sweeping terms. It refers to "two or more organizations, trades, or businesses (whether or not incorporated, * * * and whether or not affiliated) owned or controlled directly or indirectly by the same interests." The type of control contemplated by these provisions is reflected in the regulations which deal with the concept in all-embracing language as follows (Regulations 111, Sec. 22.45-1(3)):

The term "controlled" includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode or its exercise. * * *

It is wholly unimportant that the Goodman trusts which owned stock in National and Industries were not the same Goodman trusts which were the record partners in Hosiery and Abar. The significant thing is that each of the two Goodmans in fact exercised control that was commensurate with the holdings of his family, and that Kobin in fact exercised control commensurate with the holdings of his family. We have no doubt that all four organizations were "owned or controlled directly or indirectly by the same interests." Cf. Forcum-James Co., 7 T. C. 1195, 1215-1216.

3. The existence of the requisite common ownership or control is not sufficient, however, to justify the application of Section 45. The Commissioner may make a distribution, apportionment or allocation under Section 45 only "if he determines [that it] is necessary in order to prevent evasion of taxes or clearly to reflect the income of such [owned or controlled] organizations, trades, or businesses." The purpose of Section 45 is not to punish the mere existence of common control or ownership, but to assist in preventing distortion of income and evasion of taxes through the exercise of that control or ownership. It is where there is a shifting or deflection of income from one controlled unit to another that the Commissioner is authorized under Section 45 to act to right the balance and to keep tax collections unimpaired. Asiatic Petroleum Co. v. Commissioner, 79 F. 2d 234, 236 (C. A. 2), certiorari denied, 296 U. S. 645; Treas. Reg. 111, Sec. 29.45-1; cf. Gordon Can Company, 29 B. T. A. 272.

It has been said many times that the Commissioner has considerable discretion in applying Section 45, and that the determinations required of him under the statute must be sustained unless that discretion has been abused. Our review of those determinations is not de novo, and we may reverse them only where the taxpayer proves that they are unreasonable, arbitrary, or capricious. See, e. g., G. U. R. Co. v. Commissioner, 117 F. 2d 187, 189 (C. A. 7); National Securities Corp. v. Commissioner, 46 B. T. A. 562, 564, affirmed, 137 F. 2d 600, 602 (C. A. 3), certiorari denied, 320 U. S. 794; Seminole Flavor Co., 4 T. C. at 1228.

Applying this standard, we conclude that the allocations of Abar's income were arbitrary as to both Industries and National, that the allocation of Hosiery's income to In-

dustries was reasonable and justified by Section 45, and that the allocation of Hosiery's income to National was not authorized by Section 45.

a. Abar. Abar purchased waste and defective hosiery from Industries and National, as well as from other sources, paying established market prices therefor. It either repaired the hosiery or reclaimed the yarn. In the case of the repaired hosiery, Abar would have it dyed and finished by National, paying standard charges for such services, and would then sell the hosiery to jobbers. The reclaimed yarn it would sell primarily to Industries, National and Fulton (an organization controlled by the Goodmans), although it made some sales to other purchasers. It received established market prices for its reclaimed yarn. We think that the Commissioner's attempt to make allocations of Abar's income was arbitrary and unauthorized by Section 45.

Nor is a contrary conclusion warranted because it was not shown that independent capital was an important factor in Abar's operations, or that it had any employees independently of those of petitioners or some other similarly controlled organization; or because its machinery was owned by petitioners or another similarly controlled organization, and its operations were carried on at the premises of one of those organizations; or because its mended hosiery was finished by National. Cf. Miles-Conley Co., 10 T. C. 754, affirmed on another issue, 173 F. 2d 958 (C. A. 4); Buffalo Meter Co., 10 T. C. 83; Seminole Flavor Co., 4 T. C. 1215; Briggs-Killian Co., 40 B. T. A. 895. The area in which Abar operated was a separate and distinct phase of the industry, and it was, moreover, a phase never before entered either by National or Industries. And despite all the intertwining relation-

ships, the fact remains that Abar paid and received fair market prices, as though its transactions had been carried on with strangers. No more could be expected of it. While the interests controlling Industries and National could have set up salvage departments within those corporations, the uncontradicted testimony was that a single mill usually did not have enough waste to justify such a step, and, in any case, there was no obligation to adopt the course which carried the greater tax burden. Cf. Central Cuba Sugar Company, 16 T. C. 882, at p. 892.

b. Hosiery. It is important that Hosiery's position in the scheme of things be clearly understood. Industries had a so-called grey mill at Grenada, Mississippi. It had no facilities for dyeing or finishing its product. It shipped its hosiery in the grey directly to National at Indianapolis, where the hosiery was dyed and finished, at standard prices for such services, which included a fair profit above costs to National. Title to the hosiery remained in Industries. This arrangement was worked out directly between Industries and National as early as April 1938.

Hosiery's predecessor, Knitting, was first organized in March 1938. At some undisclosed time, Knitting entered into an oral agreement with Industries to furnish styling and merchandising services to Industries and to arrange for the sale of Industries' products. Neither Knitting nor Hosiery had any machinery or plant; neither had a sales organization; there is no evidence that either of them had any tangible physical assets of any consequence; the address of both was the same as National's address; neither Knitting nor Hosiery had any employees who were not also officers or employees of Industries or National; the initial capital of Hosiery was fixed at the comparatively nominal amount of $4,286.25, and even that amount was

not contributed in cash or assets other than notes. Capital was not a factor in Hosiery's operations which consisted almost entirely, as far as we have been able to determine from this record, of part-time or occasional services rendered by the two Goodmans and Kobin.

The foregoing summary is not intended to suggest that Hosiery should be disregarded as a sham; indeed, we have already concluded that Hosiery's separate entity will be recognized. But it is highly relevant to examine the functions performed by Hosiery in correct perspective, in order to determine whether income that was really earned by Industries has been artificially diverted to Hosiery; and a helpful guide in seeking the answer to that inquiry is whether the charges made by Hosiery for its services were disproportionate to the value of such services.

What was the nature of the services performed by Hosiery? There is no evidence that any of the record partners in Hosiery performed services; we are informed only of services alleged to have been performed by the two Goodmans and Kobin, as employees by Hosiery. Each of these three persons, however, was also actively engaged in the hosiery business as an officer or employee of other organizations, such as National. Thus, National's returns for 1941 state that Kobin devoted full time to its business and its returns for 1942 disclose that he devoted three-fourths of his time to its business. It is plain that the services of the two Goodmans and Kobin, as employees of Hosiery, were only on a part-time or occasional basis.

There were, nevertheless, valuable services, and included furnishing ideas for design and styling of Industries' product, the establishment of various brand names

for that product, as well as the development of other merchandising ideas and plans. In addition, they procured directly several large purchasers for Industries' product, such as Sears, Roebuck & Company. However, apart from the few large purchasers, Hosiery did not, through its employees, do any selling. The great bulk of the sales was made by National's sales organization, and for those services National was paid its costs plus a fair profit. Petitioners contend that Hosiery "engaged" National's services. Certainly, this is not true as to National's services in dyeing and finishing Industries' hosiery, for, by contract of April 12, 1938, National agreed directly with Industries to perform such services for Industries. And although Hosiery may have gone through the formality of "engaging" National's sales organization, we think it contributed nothing of value to Industries in that respect, for Industries could have arranged that matter directly with National, just as it had made direct arrangements with National to dye and finish its hosiery.

Petitioners contend that this is an inappropriate case for the application of Section 45, since Industries received a fair price for its hosiery in the grey. But the fatal defect of that contention is that Industries did not sell its hosiery in the grey. Had Hosiery purchased Industries' product in the grey, thereby assuming all responsibility as well as the risk of the market from that point forward, there would be substance to that position. But that was not the case. Industries manufactured hosiery in the grey; it shipped the hosiery to National for dyeing and finishing, for which it paid standard charges; and it at all times retained title to its product. Hosiery did render styling and merchandising services, as well as sales services in the case of a few large purchasers. But Hosiery did not buy Industries' product for resale. Nor did it guar-

antee that Industries would receive any fixed or minimum return on its product. It was Industries' finished product that was being sold to the trade, not the product of Hosiery. And it is wholly fallacious to contend that Industries was entitled to receive only a fair price for its hosiery in the grey. It was entitled to receive the full price paid for its finished product minus such fair charges as may have been incurred for dyeing, finishing, and sales services furnished by National, and minus also such fair charges for styling, merchandising, and other services actually rendered by Hosiery. To the extent that the arrangement between Hosiery and Industries resulted in a larger concentration of profits in the hands of Hosiery, to the detriment of Industries, this case presents a typical situation for the application of Section 45.

What, then, was the fair value of the services rendered by Hosiery? As we have indicated above, the partnership, as such, furnished nothing of value to Industries, apart from the services of the two Goodmans and Kobin—services which Industries could have engaged directly, if Hosiery (or its predecessor, Knitting) had not been created. However, Hosiery was entitled to receive the fair value of the services rendered by the two Goodmans and Kobin as its employees. The evidence as to that value was not entirely satisfactory, and the best measure we can find, in the evidence before us, of the value of those services is the salaries that were in fact paid for them. Cf. Welworth Realty Co., 40 B. T. A. 97, 100-101. There was testimony that those salaries were fixed by agreement with the Goodmans and Kobin; that they participated in determining the amounts of the salaries; that in fixing those salaries they considered the reasonable value of their services; and that the salaries as fixed were considered fair compensation.

It may be that the amounts of these salaries were in some way affected by the fact that the employer, Hosiery, was controlled by the employees, the Goodmans and Kobin, and that its profits would directly or indirectly benefit them or persons closely related to them. The fact that the salaries declined in later years is not enough to establish that any special concession was made; another plausible explanation for the decrease appears in the evidence. L. L. Goodman testified that the major merchandising job came in the earlier years, with the task of establishing a market for the Industries' product, and that "once the brand got established and the public repeated on it, it from then on went on its own momentum." In the later years, therefore, the Goodmans' and Kobin's services were reduced, and a reduction in their compensation was not at all surprising. This, in substance, seems to be affirmed by petitioners in their brief, where they say that "These compensations were not in the category of 'salaries' for continuing services, which ordinarily are more or less uniform through the years."

In any event, the burden was on Industries to prove the value of the services Hosiery rendered, and it has provided no more convincing evidence of that value than the salaries in question. Petitioners insist that once they have shown application of Section 45 and the allocations thereunder to be arbitrary, the burden shifted to respondent to prove a proper allocation. While there may be doubt as to the validity of this contention, we need not consider it, because we do not believe that Industries can establish that the allocation of Hosiery's income made to it by respondent was arbitrary without showing the value of the services it received from Hosiery.

L. L. Goodman's testimony suggests in a general and undefined fashion that Hosiery's services to Industries extended beyond the merchandising and other services already noted, performed by the Goodmans and Kobin, and that therefore it was not unreasonable for Industries to pay Hosiery more than just the value of those services. We find nothing in that testimony or in other evidence to show exactly what these additional functions were, and we are not convinced that in fact there were any. The claim itself seems to amount to little more than that the experience, interest and resources of the Goodmans and Kobin were marshalled behind Industries' product. To the extent that this was reflected in the services they rendered, compensation therefor must be taken to be included in the salaries they received. Over and beyond that there was nothing Industries did not already derive from its own connections and relations with the Goodmans and Kobin. Cf. R. O. H. Hill, Inc., 9 T. C. 153, 157-158.

Petitioners challenge the deficiencies on the further ground that the respondent made allocations of Hosiery's "net" income, and not its "gross" income. Cf. Chelsea Products, Inc., 16 T. C. 840. There is confusion in the record as to the label to be applied to the amounts allocated by respondent. The respondent's deficiency notices, which form the basis for these proceedings, refer to the amounts as "gross" income, whereas reports of a revenue agent, introduced in evidence to show the detailed computations, refer to the amounts as "net" income. We think that respondent's explicit determination in his statutory notices of deficiency that he was allocating "gross" income cannot be reversed, in view of the nature of the transactions carried on between Hosiery and Industries. Hosiery itself neither bought nor sold the product manu-

factured by Industries, but only provided certain services respecting that product. Therefore, contrary to the manner in which it executed its tax returns, the amounts at which Industries' finished product was sold were not Hosiery's "gross receipts" but those of Industries; Hosiery had no "cost of goods sold," and no "inventory"; and the expense of finishing, dyeing, and selling Industries' product was in fact the expense of Industries and not of Hosiery. Hosiery's returns, which were based upon the theory that it sold its own goods, were therefore misleading. In fact, other than the salaries paid by Hosiery and some small tax liability,[5] it is not clear that Hosiery had any expense of operation. We approve an allocation of Hosiery's gross income to the extent that such gross income in fact exceeded the fair value of the services rendered by Hosiery to Industries, and we think that, in essence, respondent did substantially that here (after making an allowance of a 10 per cent return on the partners' capital). The deficiencies proposed against Industries are not greater than they would have been, had Hosiery filed returns which accurately set forth its gross income and had the Commissioner made explicit allocations of portions of those amounts—allocations which we approve. In the circumstances, we find no error in the proposed deficiencies against Industries.

However, the Commissioner did more than make an allocation of a portion of Hosiery's income to Industries; he also allocated a portion thereof to National. We think that action was unauthorized by Section 45. National received a fair price, including a reasonable profit, for the dyeing, finishing, and sales services which it rendered

[5] Hosiery's tax returns claimed deductions for taxes for its fiscal years ending in 1941, 1942, 1943 and 1944 in the following respective amounts: $413.21, $550.18, $618.05, $724.80. Except for $3.21 for state personal property tax in the 1941 return, these amounts consisted of social security taxes and state gross income taxes.

with respect to Industries' product. Thus, National's earnings in relation to such services were accurately reflected in its returns, and there is no basis on which to attribute to National any further profits growing out of the sale of Industries' product. We therefore disapprove the deficiencies asserted against National to the extent that they reflect allocations from Hosiery.

Decisions will be entered under Rule 50.

(Seal)

DECISION.

The Tax Court of the United States,
Washington.

National Hosiery Mills, Inc., Petitioner,
vs. Docket No. 24640.
Commissioner of Internal Revenue, Respondent.

Pursuant to the findings of fact and opinion promulgated herein August 22, 1951, directing that decision be entered under Rule 50, the respondent, on October 4, 1951, filed a proposed computation for entry of decision which was duly served upon petitioner, and petitioner having appeared by counsel at the hearing without submitting any different computation, it is,

Ordered and Decided: That there are deficiencies in taxes and penalties as shown below:

Year	Kind of Tax	Deficiency	Five percent Penalty
1940	Income	$ 6,913.16	—
	Declared value excess-profits	1,290.01	—
1941	Income	7,314.64	—

	Excess profits	8,769.12	—
1942	Income	3,954.90	—
	Declared value excess-profits	313.87	—
	Excess profits	None	—
1943	Declared value excess-profits	175.13	—
	Excess profits	15,582.60	$779.13

(Signed) ARNOLD RAUM,
Judge.

Enter: Entered Mar. 6, 1952.
(Seal)

DECISION.

The Tax Court of the United States,
Washington.

Grenada Industries, Inc., Petitioner,
vs. Docket No. 24571.
Commissioner of Internal Revenue, Respondent.

Pursuant to the findings of fact and opinion promulgated herein August 22, 1951, directing that decision be entered under Rule 50, the parties, on March 3, 1952, filed an agreed computation for entry of decision. It is therefore

Ordered and Decided: That there are deficiencies in income, declared value excess-profits and excess profits taxes as shown below:

Fiscal Year ended	Kind of Tax	Deficiency
March 31, 1941	Income	$25,019.41
	Declared value excess-profits	10,265.16
	Excess profits	13,176.95

March 31, 1942	Income	13,750.49
	Excess profits	11,475.52
March 31, 1943	Income	5,931.66
	Excess profits	20,338.67
March 31, 1944	Income	9,060.03
	Excess profits	27,365.64

(Signed) ARNOLD RAUM,
Judge.

Enter: Entered Mar. 6, 1952.
(Seal)

OFFICIAL REPORT OF PROCEEDINGS

Before The Tax Court of the United States.

Filed Nov. 13, 1950.

Docket Nos. 24571, 24640.

Grenada Industries, Inc.; National Hosiery Mills, Inc.,
Petitioner,
vs.
Commissioner of Internal Revenue, Respondent.

Hearing at Indianapolis, Indiana.

Date October 31, 1950.

The Tax Court of the United States.

Grenada Industries, Inc., Petitioner,
vs. Docket No. 24571.
Commissioner of Internal Revenue, Respondent.

National Hosiery Mills, Inc., Petitioner,
vs. Docket No. 24640.
Commissioner of Internal Revenue, Respondent.

Room 216, U. S. Post Office, Indianapolis, Indiana, Tuesday, October 31, 1950.

Met, pursuant to notice, at 2:00 o'clock p. m.

Before: Hon. Arnold Raum, Judge.

Appearances:

Robert A. Littleton, 1021 Tower Building, Washington, D. C., appearing for the petitioners.

Lester M. Ponder, 635 Architects and Builders Building, Indianapolis, Indiana, appearing for the Respondent.

Proceedings.

The Clerk:

Docket Numbers 24571 and 24640, Grenada Industries, Inc., and National Hosiery Mills, Inc.

Mr. Littleton:

We are ready to proceed in that case, your Honor.

Mr. Ponder:

That is correct, your Honor.

Mr. Littleton:

If your Honor please, I would like to make a motion at this time that these cases be consolidated for hearing and briefing. They have all along been treated together, but no formal motion to that effect has been made.

Mr. Ponder:

The Respondent concurs in that motion, your Honor.

The Court:

Granted.

Mr. Littleton:

If your Honor please, in the case of National Hosiery, in the assignments of error: There are assignments of error 4 (a), which has to do with depreciation adjustment; assignment 4 (b), which has to do with a disallowance of a part of officers' salary, assignment 4 (c), which has to do with the allocation issue; assignment 4 (d), which also has to do with the allocation issue with reference to the Abar Process period—assignment 4 (c) is the allocation with reference to the net income of Genada Hosiery Mills. And Assignment 4 (e) has to do with the proposal to assess a delinquent penalty with respect to the excess profits tax return of the taxpayer for the period ending December 31, 1943. Assignment 4 (f) has been eliminated from the petition by previous motion.

We, at this time, desire to abandon assignment 4 (a), 4 (b), and 4 (e), so that the issue to be tried will be the issue presented by assignments 4 (c) and 4 (d), the allocation issues.

In the case of Grenada Industries, assignment 4 (a) has to do with the allocation of net income of Grenada Hosiery. Assignment 4 (b) has to do with the allocation of the net profits of Abar Process Company. Assignment 4 (c) has to do with the Section 722 claim, which has been eliminated by previous motion. So that the only issues in the Grenada case are the allocation issues.

I will give your Honor a brief statement of the underlying facts. National Hosiery Company was organized in about 1928 for the purpose of manufacturing hosiery, full-fashion hosiery, ladies' hosiery in the grey, finishing by dyeing, and also selling its products to the trade.

From 1928 to 1937, approximately, National Hosiery Company used what is known as the Trojan organization of the Realsilk Hosiery Mill, also an Indianapolis corporation, for the sale of its finished products to the trade; so that it was engaged in the business of manufacturing the hosiery in the grey, finishing them, dyeing them, and packing them, and having them sold for its account through the Trojan Sales Department of the Realsilk organization.

Grenada Hosiery Mills has always, and through the period involved here, been what is known as a grey mill. It has nothing to do with, no department for, the finishing of its hosiery. It has no department for the sale of its hosiery. It merely manufactures in the grey; and when the grey process is completed, then it entered into a contract, we think, of bailment with the National Hosiery Company, whereby its hosiery would be shipped from Grenada, Mississippi to the National Hosiery Company at Indianapolis, and there it would be finished in the finishing mill of National, packed, stored,

subject to the order of Industries or anyone that it might designate to act as its sales organization.

If your Honor please, in order to keep the record clear, I think we will refer to National Hosiery as National and to Grenada Industries, Inc. as Industries.

Industries, not having a merchandising or sales organization, employed the services of Grenada Knitting Mills, Inc. We will refer to it as Knitting. Grenada Knitting Mills, Inc. was composed of the stockholders of Industries, identical with Industries. It was organized in March, I think, of 1938. Industries was organized in October 1937 and started production of hosiery in the early part of the calendar year 1938.

Industries has a fiscal period ending March the thirty-first. National has a fiscal period ending December the thirty-first.

Knitting has a fiscal period ending June 30.

Knitting employed as its officers J. A. and L. L. Goodman, brothers, who had since the early 1920's been connected with the Realsilk Hosiery Mills and had organized the Realsilk Hosiery Mills and established its merchandising department and policies, and were with Realsilk until along in October 1937, when they severed their connection with that organization and went over to National.

I might say that Messrs. J. A. and L. L. Goodman were instrumental in the organization of the National Hosiery Company, along with Mr. Henry V. Kobin. They were also instrumental in organizing Industries in October 1937,

along with Mr. H. v. Kobin, as a grey mill, to operate its mill at Grenada, Mississippi.

The merchandising plan for the hosiery produced by Industries was formulated and adopted and established by Knitting through the services of its officers, J. A. and L. L. Goodman.

It entered into an agreement with National to use the sales organization of National to sell the finished merchandise, or the hosiery, of Industries, when finished, according to the merchandising plan formulated by the Goodmans.

Knitting acted as the merchandising organization and in supervision of the sales organization for Industries until about June 30, 1940, at which time its stockholders and Board of Directors decided that it would discontinue the active business and transfer all of its accounts, contracts, and other paraphernalia of property to a partnership known as Grenada Hosiery Mills. We will refer to that organization as Hosiery. Grenada Hosiery Mills, a partnership, employed the services of Messrs. J. A. and L. L. Goodman to work for it and render services to Industries in the same capacity that Knitting has been rendering merchandising and the supervision of the sales organization and supervising the finishing and packing of the hosiery of Industries. That was the organization that existed during the period we have here.

I mentioned a while ago that the hosiery in the grey would be shipped to National under the bailment arrangement, to be finished, dyed, packed; and then it would be, as it was sold to the trade, given an identification number of a style. Now, the style of hosiery identified as being manufactured from the Industries Mills was distinct and separate from the style of hosiery manufactured at the National Mills. It was a different grade and a different quality of hosiery. It was produced upon different types

of knitting machines, and it was produced under a different merchandising plan with reference to styling.

As orders were received for the hosiery, it would be sold as Industries hosiery. It would be received at National. National's bookkeeping department and sales department and billing department would identify from the orders the quality and class of hosiery and make up an invoice; and maybe in that invoice there might be a hundred dozen of Grenada hosiery and fifty dozen of National hosiery, but the identification would be there on the styling. So that invoice would be passed and would be segregated and analyzed and would be put on the books of the different organizations. National would set it up as accounts payable to Hosiery so far as the order represented hosiery sold from Industries stock, and Hosiery would set it up as an accounts receivable; and when the order was paid for, if it were billed in the name of National, National would receive the check and it would immediately set up an order of accounts payable to Hosiery. And when it paid Hosiery, it would give it credit and send its check for the amount that represented the goods that had been sold through its sales organization and had been received by it from the trade.

The books were kept distinctly separate at all times. They knew what hosiery was sold out of Industries' stock and what hosiery was sold out of National's stock. National would invoice Industries for the cost of finishing, of packing, the hosiery. Industries would pay National and then charge that against Hosiery, and when Hosiery paid Industries for its grey goods it would also reimburse it the amount that it had paid out for finishing. So that what Industries sold was its grey goods, at a fair price, determined by the market, with respect to each lot; and care was exercised in that respect. So, it had its manufacturing cost of the grey hosiery.

Hosiery kept an accurate account of all of its administrative—by the way, in that packing and finishing, there was also shipping expense, that was billed to Industries by National. Hosiery kept an accurate account of its administrative and selling expense. Now, the selling expense was paid to National, using National's organization, and National would invoice Hosiery for the amount of its charges for selling its merchandise through its sales organization.

With reference to the sales that were made to Sears, Roebuck, which were substantial, out of the Industries merchandise, that would be invoiced by Hosiery to Sears, Roebuck, and it would be paid to Hosiery by Sears-Roebuck; and the same thing was true with reference to Marshall Field, all of Marshall Field's sales.

Abar Process is what its name implies, and we refer to that as Abar. It is a partnership. It was introduced by Mr. A. J. Barskin, who came here from Philadelphia first with the Realsilk organization and second with National, and during this period he was also with National, notwithstanding he was the active partner in Abar.

Now, every mill has a certain quantity of waste in the knitting of hosiery. The hosiery starts on the machine, and something will happen to it. The thread will break, and it may have to be taken off entirely and discarded. There will be certain flaws in certain hosiery.

Abar would buy waste material produced at the grey mill of Industries, at the grey processes of National, at the grey processes of Fulton. Fulton was a partnership, but it is not involved in this proceeding.

And he would buy waste material at any other mill where he could find a supply of waste material in the knitting of hosiery, paying therefor what the prevailing market was, which in this period was about 50 cents a pound for the waste. He had invented a machine, Mr.

Barskin had, to reclaim the yarn from partially knit hosiery or wholly-knit hosiery of irregular quantity for which there was no market as hosiery. He unraveled it and recombed the yarn so that it could be put back into use in knitting hosiery. And he sold the yarn to National, Fulton, and Industries at the prevailing market price for such merchandise.

In the waste material that it acquired from the other mills, the three mills that I have mentioned, Industries, National, and Fulton, there were to be found hosiery that could be mended. So therefore he set up the processes of mending the hosiery that could be mended, and selling it as finished hosiery. But it employed the services of National to finish. It was in the grey. The hosiery that he bought as salvage was in the grey.

Abar employed the services of National to finish, grade, pack, and ship the hosiery, and sell it for the account of Abar, paying National a fair price according to the customs at the time for that work, per dozen. It had its own processing expense, cost of goods sold; and a separate and complete set of books was kept by that organization.

But in keeping those records, the services of the bookkeeping department of National were employed, and National was paid a fair price for that service to Abar.

Now, if your Honor please, the Commissioner in his audit of these returns of these various companies for all of the years has made no adjustment in the reported cost of goods sold. He made no adjustment in the inventory on hand. He has made no adjustment in the sales price of the merchandise with respect to the gross income. The only adjustments which give rise to the deficiencies proposed are with respect to certain deductions.

In the case of National Hosiery for the period ending December 31, 1940, he has disallowed depreciation in the amount of $24,000, net operating loss carryover from

previous year of $397, amortization on reorganization expense $354; and then he has allocated $3,819.94 of the net profits of Grenada Hosiery Mills. Now, that is the only adjustment, there, that we take issue with, just the allocation.

That is true with reference to all the years, after we have waived the errors that I have referred to a moment ago, and that is true with reference to Grenada. He has disallowed certain deductions, which would be shown on our return, and has included the restoration.

Now, in Grenada for the year ended 1941, March 31, 1941, the first year, he disallows prepared manufacturing expense of $6,000, rental on machines of $20,000, net operating loss carryover from 1940 of $23,000, and then he restores as income to us $62,068.57 of the net profits of Hosiery. That is the issue that we protest. And he takes the net issue as shown by the return and adjuts it in that respect. Where we reported $37,000 net, he raises it to $151,000. So there is where the trouble begins between us, and we are protesting only his proposal to allocate the net profits of another business organization, a separate business organization.

Abar comes into the picture for 1942. It was organized in January 1942. The picture there, from then up until this period, covers the year '43 for National and the period through March 31, 1944 for Industries. They are the only two taxpayers in the picture. And we will expect to show to your Honor by the testimony and by documentary evidence that Industries was an independent business organization, that National was an independent business organization, that Hosiery was an independent busienss organization, that Abar was an independent organization, and that while they were in a related industry they yet operated independently of each other, and there is no overlapping or shifting of gross income ex-

penses or deductions in any particular whatsoever. And the Commissioner has not made any finding with respect to that phase of the business operation.

I think, your Honor, that that gives a picture of what we are to hear testimony on and ultimately get a decision on.

Mr. Ponder:

If it please the Court, despite the large number of organizations and related trusts which have not as yet been mentioned but which will be developed in the evidence, involved in these cases, the two cases actually may be summarized as containing only two litigable issues at this time. That is, first, did the Commissioner err in allocating to each one of these petitioners, which are both corporations, certain amounts of income which had been reported by a purported partnership, which will be referred to for purposes of convenience as Hosiery, but which bears the rather confusing title of Grenada Hosiery Mills. I say "confusing," because we also have one of the petitioners named Grenada Industries, Inc.

Now, the second issue is identical with that pertaining to this purported partnership, except that it pertains to the issue, or rather it is the issue, of whether the Commissioner erred in allocating certain income reported by a purported partnership known as Abar Process Company to these two petitioners. In other words, as will more specifically appear as the evidence develops, the Commissioner has used a certain basis in making an allocation of all of the income reported by Hosiery partnership and by Abar partnership to these corporations after certain other deductions have been allowed by the Commissioner but were not taken on the returns. The Commissioner did not take the net reported income, in other words, of these two purported partnerships and

allocate that, but he also, as will more specifically appear in the evidence, took the reported incomes and then gave some additional deductions and then took that net and allocated that on a basis which will be, as I say, specifically set out.

Now, it is the Commisioner's position in this case, and it is his belief the evidence will show, that all of these organizations, including the two petitioner corporations and all of the purported partnerships, were closely related organizations which were organized, dominated, and controlled by the same identical family interests throughout. The evidence will show that numerous trusts were created by Mr. J. A. Goodman, Mr. L. L. Goodman, and Mr. H. V. Kobin, the original organizers of National Hosiery Mills, Incorporated, and that these trusts were conveyed or were set up as having at least paper interests in these various partnerships.

Now, it is the Commissioner's position, and he has so determined in these proceedings, that in truth and in fact the income which was reported by these purported partnerships were actually earned by and the income of these two corporations in the proportions that he has now allocated under Section 45.

The Commissioner has determined that in order to properly and clearly reflect income of these petitioners and to prevent evasion of taxes, as is expressly set out in Section 45, it is necessary for an allocation to be made placing this income in the taxable income of the two petitioner corporations.

Now, it is also the petitioner's position, in the alternative, and he has so determined in the notices of issues, that if an allocation is not deemed by this Court to be proper under Section 45, the determined adjustment to income of the two corporations should be made under Section 22 (a), on the ground that the income reported

by these two purported partnerships was actually earned by the two corporations, and therefore the two corporations should now pay the tax on such income.

I might point out in passing that the evidence will show that Hosiery had no separate business organization. It kept a set of books, and the evidence will show that there were intricate paper transactions recorded.

But the evidence will also show that there is no reality behind the paper transactions, and that in truth and in fact National performed certain functions which were then recorded on the books of Hosiery, and that Industries performed other functions which were recorded on the books of Hosiery.

And I might also point out, in passing, that the books were all kept under the supervision of the same accountant by the same bookkeepers in the same office, and it is our position that actually all of this so-called income earned by these purported partnerships was actually earned by the corporations, and the corporations are the only taxable entities having life and being and reality which can be recognized under the numerous cases of this Court and Circuit Courts and the Supreme Court, holding that taxation is an intensely practical matter and that substance must always be inquired into rather than an intricate maze of forms.

I think that that sufficiently states the Respondent's position; and as the evidence will develop I believe the facts will become in clearer focus.

I do think it is absolutely vital that these different organizations are referred to consistently. I notice that counsel for petitioner inescapably referred certain times to Industries—I know inadvertently—as Grenada. Because it is very difficult to keep them separate. But we will get into a great deal of confusion if we don't follow the same format; that is, referring to National as National,

and then Grenada Industries, Inc., the corporation, as Industries, and then Grenada Hosiery Mills, the purported partnership, as Hosiery; and then Abar, of course, is simple, and has no confusion, and we can call that Abar.

Then, in order not to be confused, it must be remembered, as counsel for petitioner pointed out, that prior to June 30, 1940, the Grenada Knitting Mills, a corporation, which is not involved in the taxable period before the Court in these cases, was in existence, and that it went out of existence as of June 30, 1940, and that after that time the purported partnership of Grenada Hosiery Mills then was in existence throughout our taxable period here.

And I just want to mention one further thing in closing, and that is that there will be, of course, inevitably in the trial of this type of case frequent references to a partnership. Now, I am not going to tax the patience of this Court by jumping up and objecting every time the word "partnership" is used, for example, by counsel for petitioner in asking a question, and I might even myself forget and use the word, too. That is in order to shorten the proceeding. I want your Honor to understand that if "partnership" is used and counsel for respondent doesn't object each time, it doesn't mean that we recognize that there was an actual business partnership involved. But in order to shorten the time, I don't intend to jump up each time. But you understand our position. We are not recognizing the actuality and substance of these partnerships. I won't make constant objections, but I just want that to be clear, that my omission is not due to any lack of understanding of that situation. I just wanted to be understood, though, that it will help to shorten trial time, and I know in referring to these things it is inevitable that they will be referred to in that way.

Mr. Littleton:

I just want to make one observation, your Honor.

Grenada Knitting Mills has not discontinued. It has simply discontinued active business. Its charter continued on.

Mr. Ponder:

I understood, your Honor, I understood it has been dissolved. I don't believe it played any part—

Mr. Littleton:

No. Its organization was kept alive, though.

Now, with reefrence to the position in the deficiency notice, those partnerships are recognized as partnerships, and they are permitted to retain out of the profits earned an amount that equals 10 per cent of the contributed capital. That is the deficiency notice stemming from the agent's report. And the agent's report goes into detail, and the partnerships are recognized as having earned out of the net profits that they reported only an amount that equals 10 per cent of the contributed capital; not the capital used in the business. They did have a substantial capital used by accumulated surpluses. And he allows Mr. A. J. Barskin a salary of a thousand dollars a year in connection with the Hosiery partnership, and a thousand dollars a year in connection with the Abar partnership.

As I say, so far as I know now, there is no request or position on behalf of the Commissioner to disregard these partnerships. I think they have been recognized as entitites.

The Court:

Well, as I understand the operation of Section 45, the recognition or non-recognition of any of the constituent

organizations involved is not an essential part of the statute. In fact, the statute proceeds upon the assumption, as I understand it, that there are separate recognizable organizations, but for reasons outlined in the statute, the Commissioner is authorized, if the facts so justify it, to make certain reallocations.

Mr. Littleton:

Yes, if he finds that the income is not truly corrected and will show that there has been a shifting of expenses from a prosperous company to a nonprosperous organization, therefore hiding the expense and sucking up, or "milking off" as they say in the committee reports—But in order to do that, there must be two or more business organizations.

The Court:

Well, unless the evidence justifies a recasting of the issues, then we are not here trying either the existence or nonxistence of these organizations. Am I correct in that?

Mr. Ponder:

I would say that is as far as the paper organization goes. We have determined in the alternative that the partnerships are not recognizable for tax purposes. I didn't intend to engage in further argument, in other words, at this time. I feel this is a matter that should probably be fully developed in brief.

The Court:

It is a bit premature.

Mr. Ponder:

I don't want to acquiesce, again, in the statement of counsel for petitioner that we recognize partnerships. I realize there may be an arguable question there as to whether or not we have. But it is our position that in allowing the deduction which he has mentioned, of 10 per cent on the capital account, and a salary deduction, we have tried to follow the instruction of the statute to clearly reflect income, and the Commissioner has determined that in order to do so some amounts should be allowed over and above those which were taken on return. That is what has been done.

The Court:

I have your point.

Mr. Littleton:

Now, your Honor, I would like to have in evidence the returns filed by the two petitioners. And we can probably put the original returns in and substitute photostatic copies from the Commissioner's files. In that category, I take it that those might be designated as joint exhibits.

Mr. Ponder:

Yes. That would be satisfactory. I have these returns here.

Mr. Littleton:

I would like to offer in evidence as Joint Exhibit 1A the corporation income and declared value excess-profits tax return of National Hosiery Mills for the calendar year ending December 31, 1940.

The Court:

These are returns of National?

Mr. Littleton:

Yes, your Honor.

The Court:

The next one you have, which will be 2B, is for the year ending when?

Mr. Littleton:

December 31, 1941. Then 3C will be for the calendar year ending December 31, 1942, and 4D will be for the calendar year ending December 31, 1943.

The Clerk:

Marked for identification, Joint Exhibits A1, B2, C3, and 4D.

(Joint Exhibits A1, B2, C3 and 4D were marked for identification.)

The Court:

Before you proceed with that, I am a little confused about these four returns that you have offered.

What is the period covered by the first one?

Mr. Littleton:

December 31, 1940.

The Court:

I see.

Mr. Littleton:

And the next is December 31, 1941, then December 31, 1942, and then December 31, 1943.

Then Grenada Industries for the period ending March 31, 1942 will be Joint Exhibit 5E; for the period ending

March 31, 1942, 6F; for the period ending March 31, 1943, 7G; for the period ending March 31, 1944, 8H.

The Grenada Hosiery Mills, partnership return of income for the period ending March 30, 1941, will be 9I. The same for the period ending June 30, 1942 will be 10J. The same for the period ending June 30, 1943 will be 11K. The same for the period ending June 30, 1944 will be 12L.

The partnership return of income for Abar Process Company for the fiscal year ending September 30, 1942 will be 13M. The same for the period ending September 30, 1943 will be 14N.

The Clerk:

Marked for identification; Joint Exhibits 5E to 14N.

(Joint Exhibits 5E, 6F, 7G, 8H, 9I, 10J, 11K, 12L, 13M and 14N were marked for identification.)

The Court:

(Joint Exhibits A1 to 14N, inclusive, were received in evidence.)

Mr. Littleton:

If your Honor please, in order to show the adjustments made in that return and in bringing the action that has been taken, down to date, I would like to put in the revenue agent's reports, which tie in with the deficiency notices.

Mr. Ponder:

If the Court please, on that, I would like to say that respondent has no objection to the admission of the reenue agent's reports as exhibits for the limited purpose stated by counsel for petitioner; in other words, to show

the breakdown and the method of arriving at the figures which are set forth in the aggregate in the 90 day letter or the notices of deficiency.

Now, I would just like to point out that doesn't constitute the final determination of the issue. I don't want to agree to its admission for all purposes. But for that limited purpose, we have no objection.

The Court:

It may be admitted for that purpose.

Mr. Littleton:

If your Honor please, in all of these tax cases if there is any dispute at all it is with reference to the actions that have been taken by the Commissioner; and we can only show what the controversies are by showing what has been adjusted with reference to the returns. It isn't necessary for the Court to make an auditing and investigating bureau out of itself, but it does want to know that all the adjustments that are to be made have been made, and bring it down to a single issue. And I think tying in what has been done when we have a controversy, as we have in this case, we want to get all of those accounting questions and auditing questions out of the way.

I would like to offer in evidence as Petitioner's Exhibit 15 the revenue agent's report dated May 7, 1945, transmitted to the taxpayer by letter from the agent's office dated June 22, 1945, covering the period covered by the returns filed as Joint Exhibits.

Mr. Ponder:

No objection for the limited purpose, your Honor.

The Court:

Admitted.

The Clerk:
Exhibit 15, admitted in evidence.

(Petitioner's Exhibit No. 15 was received in evidence.)

Mr. Littleton:
As Petitioner's Exhibit 16, I offer the revenue agent's report of examination of the books and records and returns of Genada Industries, Inc. for the periods covered by the return, dated May 7, 1945, transmitted to the taxpayer by letter dated June 22, 1945.

Mr. Ponder:
No objection for the limited purpose.

The Court:
Admitted.

The Clerk:
Admitted in evidence; Exhibit 16.

(Petitioner's Exhibit No. 16 was received in evidence.)

Mr. Littleton:
And as Exhibit 17, the report on the partnership, or Grenada Hosiery Mills, of the same date, covering the period covered by the returns filed with the Joint Exhibits.

Mr. Ponder:
No objection for the limited purpose, your Honor.

The Court:
Admitted.

The Clerk:
Received in evidence; Exhibit No. 17.

(Petitioner's Exhibit No. 17 was received in evidence.)

Mr. Littleton:
As Exhibit 18, the report on Abar Process Company for the periods ending June 30, 1942 and September 30, 1943, in which it is stated that the returns as filed are accepted.

Mr. Ponder:
No objection for the limited purpose.

The Court:
Admitted.

The Clerk:
Admitted in evidence; Exhibit 18.

(Petitioner's Exhibit No. 18 was received in evidence.)

Mr. Littleton:
At this time, your Honor, I would like to also offer in evidence as Petitioner's Exhibit No. 19, a photostatic copy of the articles of partnership of Grenada Hosiery Mills, the original of which has been submitted to the General Counsel. And we agree that this is a correct photostatic copy of the original documents.

Mr. Ponder:
Your Honor, there again we don't object to the authenticity of the document. We object to the use of the partnership term. In other words, what I say is that we have no objection to this exhibit being received as a true copy

of a document executed on that date shown, by the signatory parties thereto.

Further than that, all we say is that it was a document, it was executed, and that is a true copy of it.

As to descriptive terminology, we wouldn't want to agree or disagree at this time.

The Court:

I am not going to let the wool be pulled over my eyes by any labels here, and I don't think counsel intends to do that.

Mr. Ponder:

I realize that for convenience purposes, it is very difficult to describe it as a document.

The Court:

I understand your point, Mr. Ponder.

Mr. Ponder:

Very well. We have no objection to its reception with that understanding.

The Court:

It will be admitted.

The Clerk:

Admitted in evidence; Exhibit 19.

(Petitioner's Exhibit No. 19 was received in evidence.)

Mr. Littleton:

That constitutes the Articles as far as they were originally drafted, or amended, as they existed in this period. They are both in that one binder. Those are the Articles constituting that partnership.

Now, in the same category, I would like to offer in evidence the Articles composing the partntrship or the organization operated under the partnership known as Abar Process Company. I submit a photostatic copy of the Article as amended, as originally drafted and amended from time to time, including copies of the trusts with respect to the trust members. That will be No. 20.

Mr. Ponder:

I can phrase it this way: No objection to the reception of the document in evidence.

The Court:

It will be admitted.

The Clerk:

Received in evidence; Exhibit 20.

(Petitioner's Exhibit No. 20 was received in evidence.)

Mr. Littleton:

If your Honor please, L. L. Goodman Trust No. 2 is a member o fthe partnership of Grenada Hosiery Mills. I would like to offer in evidence a photostatic copy of that trust indenture.

Mr. Ponder:

No objection by respondent, your Honor.

The Court:

Admitted.

The Clerk:
Exhibit 21, received in evidence.

(Petitioner's Exhibit No. 21 was received in evidence.)

Mr. Littleton:
The Jacqueline Goodman Trust No. 2 is also a member of the Grenada partnership, and I would like to offer in evidence a photostatic copy of the instrument creating that trust.

Mr. Ponder:
No objection, your Honor.

The Court:
It will be admitted.

The Clerk:
Received in evidence; Exhibit No. 22.

(Petitioner's Exhibit No. 22 was received in evidence.)

Mr. Littleton:
As Petitioner's Exhibit 23, I offer a photostatic copy of the original of a trust instrument creating the trust for Anne Kobin, or the Annie Kobin Trust; a member of the Abar partnership as well as a member of the Grenada partnership. I mean the Hosiery partnership.

Mr. Ponder:
No objection.

The Court:
Admitted.

The Clerk:
Admitted in evidence; Exhibit 23.

(Petitioner's Exhibit No. 23 was received in evidence.)

Mr. Littleton:
I offer a photostatic copy of the trust instrument creating the Trust of W. H. Kobin, who is a member of the Abar Process Company partnership as well as a member of the Grenada Hosiery Mills partnership.

Mr. Ponder:
No objection, your Honor.

The Court:
Admitted.

The Clerk:
Exhibit 24.

(Petitioner's Exhibit No. 24 was received in evidence.)

Mr. Littleton:
If your Honor please, I would like to offer as Petitioner's Exhibit 25 a chart of stockholders of National, showing the percentage of the stock owned by each stockholder, the list of the stockholders of Industries, showing the percentage of the stock held by each stockholder, the members of the partnership of Hosiery, showing the interests of each partner, the members of the partnership of Abar, showing the interest of each partner, and the name of each stockholder and of each partner.

Mr. Ponder:
There is no objection, your Honor, with the understanding that this chart is a reflection of the records of

the respective organizations. In other words, it is the stock holdings or interest holdings of record, which I understand is what Mr. Littleton has implied.

Mr. Littleton:

That is true, and the stock books of the corporations and the fractional interests of the members of the partnership are identical with this, and I just put it in in order to show the interests.

The Court:

In other words, the chart is offered not to prove the particular interest shown, but merely to reflect the formal percentages or paper interests as reflected by the books of the organization?

Mr. Littleton:

Yes.

Mr. Ponder:

With that understanding, we have no objection.

I would like to mention just one thing. That chart is expressed in fractional percentages, starting of course with 100 per cent, and then, as necessary, in fractions. And, of course if it becomes material that the parties desire to show actual number of record shares held by various trusts or individuals, I would like to ask counsel for petitioner to stipulate the total shares of common stock outstanding of each of the petitioners, which we have previously agreed on. And those amounts I think we have here.

Mr. Littleton:

Interests: common stock outstanding over all the period, 1,000 shares of common; as to National covering the period, it was 19,450.

Mr. Ponder:

The respondent so stipulates and agrees, your Honor, that those are the total figures.

Mr. Littleton:

Those are the total figures, and the stock was maintained in that number.

The Court:

There were no other classes of stock?

Mr. Littleton:

There was some preferred stock, but I think that was retired previous to this year here involved.

Mr. Ponder:

If there is any question on the preferred stock, probably that could come out in the later testimony. I don't believe it is material here.

Mr. Littleton:

The common stock was the controlling stock, your Honor, and the preferred stock was owned in the same proportions as the common.

Mr. Ponder:

I think we could simply bring that out in the testimony. If that is true, that the stock was held in the same proportions, that could be covered later on in the testimony.

What I am looking for here is the company that that first statement was made about.

The Court:

This chart reflects merely the common stock holdings, and not any preferred; is that right?

Mr. Ponder:

That is my understanding, your Honor: that that chart does express the common stock only.

The Court:

It is admitted.

The Clerk:

Exhibit 25, admitted in evidence.

(Petitioner's Exhibit No. 25 was received in evidence.)

Mr. Littleton:

Does your Honor want to take a recess at this point?

The Court:

I think this would be a convenient point.

(Short recess.)

Mr. Litleton:

If your Honor please, in the recess we have agreed that in 1941, for the period ending at September 30, 1941, which includes the fiscal year of Grenada Industries ending March 30, 1941, the preferred stock issued and outstanding was 90 shares as owned by Dorothy Adler, 563 shares as owned by the Jacqueline Goodman Trust No. 1, 97 shares as owned by the Ruth Elaine Goodman Trust No. 1, 57 shares owned by Esther M. Goodman, who was the wife of L. L. Goodman, and 418 shares owned by the Sue Ellen Goodman Trust No. 1, comprising 1225 shares.

Mr. Ponder:

Respondent stipulates and agrees that those are the record stock holdings of preferred stock of Industries as of September 30, 1941, your Honor.

The Court:

Those are not the same stockholders in the same proportions as on the common stock?

Mr. Littleton:

No.

If any changes have occurred in that stock ownership in the period, your Honor, we will bring it in before the case closes.

Now, with reference to National Hosiery for the calendar year 1940 and up until September 30, 1941, the preferred stock in 1940 was owned by Sarah Wolfe Goodman, 97-½ shares, by Sue Ellen Goodman Trust No. 1, 127-½ shares. The only change made there to September 30, 1941 was that the Sarah Goodman stock was transferred to the Jacqueline Goodman Trust No. 1, 97-½ shares, and the Sue Ellen Goodman Trust remained the same.

Before the case is closed, we will bring in the preferred stock holding through the years involved here.

Mr. Ponder:

Respondent will agree that those are the record holdings of preferred stock on the dates designated.

The Court:

I don't know whether the preferred stockholders are going to have any relevance in this proceeding or not, but if as the trial develops it should turn out that they may have relevance, counsel may wish also to indicate the character of the preferred stock, whether it is participating or nonparticipating, and so forth.

Mr. Littleton:

The statute provides "owned and controlled by the same interests."

Your Honor, if you please, we will start now on the testimony of Mr. L. L. Goodman.

Will you come over, Mr. Goodman, and be sworn?

Whereupon LAZURE L. GOODMAN, was called as a witness and, having been first duly sworn, was examined and testified as follows:

The Clerk:

Have a seat, sir, and state your name and address.

The Witness:

Lazure L. Goodman, 301 West Kessler Boulevard, Indianapolis.

Direct Examination.

By Mr. Littleton:

Q. What is your age, Mr. Goodman?

A. Fifty-eight.

Q. In what industry are you engaged?

A. The hosiery industry.

Q. How long have you been engaged in the hosiery industry?

A. Thirty-five years.

Q. Your first experience in the hosiery industry was with what organization?

A. With the Goodman Hosiery Company, in 1915.

Q. Where did that organization operate?

A. We operated in Indianapolis and in North Carolina.

Q. Did it have mills?

A. No, we were distributors of hosiery. We purchased hosiery from the grey. We had it finished for us. And we arranged to sell it to retailers and jobbers.

Q. Now, are you connected with National Hosiery Mills, Inc.?

A. I am.

Q. When did your connection with that organization commence?

A. I think in 1937.

Q. Are you familiar with the date of the organization of that company?

A. I think it was in 1928.

Q. Did you participate in the organization of National?

A. Yes.

Q. In what way?

A. Mr. Kobin started that compan. Certain members of my family invested in the company.

Q. What is Mr. Kobin's full name?

A. Henry V. Kobin.

Q. Had he previously been associated with you in the hosiery industry?

A. Yes. He became associated with me in, oh, I think, 1920 or 1921, shortly after my brother and I founded the Realsilk Hosiery Mills in Indianapolis.

Q. When was the Realsilk Hosiery Mills organized?

A. In 1920.

Q. By whom?

A. By my brother and me and by a brother of Henry V. Kobin named William C. Kobin.

Q. Your brother you referred to: was that J. A. Goodman?

A. Correct.

Q. Is he living?

A. No, he died December 20 last year.

Q. Now, how long did you continue with the Realsilk organization?

A. Until the spring of 1937.

Q. What was the nature of its hosiery business? Did it manufacture and sell, or just manufacture?

A. It did the complete job of manufacturing and selling direct to the consumer through a sales organization which it employed itself.

Q. Now, when you say direct to the consumer, does that mean—

A. Door-to-door.

Q. Door-to-door?

A. Yes.

Q. Did it employ many, or a few, solicitors?

A. It employed thousands of solicitors, whom we called salesmen.

Q. At the time you were associated with Realsilk, did you become experienced in or gain knowledge of the merchandising functions of a hosiery organization?

A. I did. I had charge of the merchandising and sales direction of the organization.

Q. Is there a distinction to be made between the manufacturing of hosiery, the merchandising, and the sales?

Are those separate functions of a hosiery organization?

A. Yes. Manufacturing is one function, and merchandising is another, and selling is another.

Q. Now, what is the manufacturing process? What does that comprehend?

A. Getting in the raw material, putting it on the machines, knitting the product, going through all the grey processes, ready to have the hosiery dyed into colors.

Q. Is the finishing of hosiery different from the manufacture, or is that a part of the manufacture?

A. Finishing is considered a manufacturing operation. Finishing comprises dyeing of hosiery, inspecting them, putting them up in pairs, into dozens, into boxes, and getting them ready for shipment.

Q. Now, the merchandising features of the hosiery organization: where do they begin? In what process of

the knitting? Is that while the stocking is being knitted in the grey, or after it is knitted and when it is being sold to the trade? Where does your merchandising function intervene?

A. Merchandising functions can intervene through both the manufacturing and the selling.

Q. Can manufacturing be carried on without the services of a merchandising organization?

A. Yes. A manufacturer can buy knitting machines, which are set up by the knitting machine manufacturer to make an ordinary staple style of stockings, and he can produce that hosiery, and he finds a market for that type of hosiery, not including any merchandising features.

Q. What would that hosiery be classed as on the market?

A. As ordinary hosiery.

Q. Would it be styled hosiery?

A. It would not be styled hosiery.

Q. It would be in the category of what type of hosiery?

A. Well, in the category of a stocking which would cover women's legs and wear satisfactorily and have the average appearance of average-made hosiery.

Q. Now, when, if you know, did the full fashion type hosiery come into vogue?

A. In the early 1920's, it started to come noticeably to the attention of the industry. Prior to that, the industry was primarily seamless or circular-knit hosiery.

Q. Now, prior to that, would hosiery be knit with an elasticity that would shape itself to the woman's leg?

A. I don't understand the question.

Q. I say, prior to the full fashion vogue, would the hosiery be knitted in a sort of straight sack proposition?

A. Yes, just a tube, and the stocking would be given very largely an artificial shape in the final finishing, but it would not fit the same as a full fashion stocking, which

would be actually knitted smaller at the ankle and knitted larger at the top and fit more like a suit of clothes fits, tailored.

Q. That hosiery is boarded in its finishing process? It is put on boards to shape it?

A. Yes, but it has its shape right in it.

Q. The shape is knitted in it?

A. Yes.

Q. Now, where do the merchandising functions of hosiery come in, and what do they comprehend?

A. That comprehends putting into a product features which will appeal to the public or make the hosiery appeal to the public as being better hosiery, either from the standpoint of appearance or wear or convenience or styled. And then, of course, the manufacturing goes along, following it to its conclusion, to see that, once the stocking has those features, the hosiery is properly exploited in advertising and in printed matter that is furnished the stores to educate the sales girls how to point out these features.

Q. At what time and in what period did you gain your knowledge of the merchandising features of the hosiery industry?

A. During the seventeen years that I was with the Realsilk Hosiery Mills as one of its founders and its chief merchandising expert, I was directly in charge of, along with my brother—we worked as a team—developing features which would make our hosiery either sell easier to the consumer or insure a higher percentage of repeat business on the product. Our experience was unique in that we dealt directly with the consumer, and when we would get complaints about hosiery not being satisfactory in one respect or another, or stockings having some shortcoming, that would come directly to my attention through the complaints that would be made by these thousands of

salesmen. And it served as a great research laboratory as to what it was that the American women wanted in hosiery to please them. Salesmen in the Realsilk Hosiery Mills were each assigned to a territory of perhaps a thousand homes to call on, and they were supposed to make their living out of calling on those same customers week in and week out, calling on each customer perhaps every sixty days or so.

Well, naturally, if a salesman called on a woman that he had sold before, and she complained that the product wasn't good, if he got enough complaints like that he would report to his district manager—we had two hundred branch managers—saying that he was going to quit because the hosiery was no good and he couldn't get repeat business.

Well, in those days, in that particular business, the Realsilk Hosiery Mills, the important thing was to keep a sales force and have as little turnover as possible. So the hosiery company was always put to the test of seeing how it could put features into a stocking to overcome these complaints, so that the sales representative could have more repeat sales that he would be making to these same women.

Of course, the hosiery business is a trouble business, in a sense. As everybody knows a stocking wears out. But the idea is to prolong the wearing life as long as you can and put features in the stocking which would cause as few accidents as possible to the stockings. Because many stockings are damaged just through accident.

We often found that we could put features into this hosiery that would satisfy customers better and would cost us no more to do it.

Q. You mean no more cost to make it with the features?

A. No more cost to make the hosiery with the features in it as without it. In fact, sometimes less costly.

For example, in the silk hosiery days, with Realsilk, when the vogue came for very sheer stockings, like, say, a two-thread silk stocking, if you furnished a woman a stocking which was too long for her, she would fasten her garter down into the thin part of the stocking instead of up into the doubled hem, and the stocking would burst into a run the first time she would wear the stockings.

Therefore, we started a system of making stockings in various lengths, so that a woman who needed a short stocking would get a short stocking and a woman who needed a longer stocking would get a longer one.

We learned, in that experience, that if you gave the public a stocking which satisfied them better, even though it cost you no more to take it you could get more for that stocking than for an ordinary stocking. And that is a merchandising principle that we learned there; that it wasn't how much material you put into a stocking, but it was how nearly the stocking you made would come to satisfy the consumer better, that particular individual consumer better, that determined her appraisal of the value of that stocking and the building up of repeat business.

And furthermore, since the cost of distribution in the Realsilk Hosiery Mills of having to hire salesmen calling door to door was a higher cot of distribution than ordinary retail store selling, Realsilk had to sell its hosiery at higher prices, and that made it all the more necessary to develop merchandising ideas which would justify the price, the higher price, that had to be charged for the stocking, if we wanted repeat business.

Q. You sold in competition with the store, the retail store?

A. Yes.

Q. Now, when did you sever your connection with Realsilk Hosiery?

A. I think it was April 1937.

Q. Did you have a stock interest in it at that time?

A. Yes.

Q. After that, did you continue your stock interest in Realsilk?

A. No, I disposed of it on the Stock Exchange.

Q. During the time you were with Realsilk, did you accumulate a substantial amount of wealth?

A. Yes.

Q. And in the interim between 1920 and your severing your connection with Realsilk in 1937, did you make certain gifts of property to your children?

A. I did.

Mr. Ponder:

If the Court please, perhaps it is not the time for an objection on the best evidence rule. I don't know. I assume if the statement has gone this far there is no objection to the question as framed, so I will withdraw any objection at this time.

By Mr. Littleton:

Q. Well, you did, while you were connected with Realsilk, make certain transfers of the stock you owned therein in trust by gift?

A. Yes, I did.

Q. Did you make transfers to your wife, and did she own stock in it?

A. Yes.

Q. During the time you were connected with Realsilk, did you have anything to do personally with the organization of any other hosiery organizations that dealt in the hosiery industry in any way? Did you have anything to do with the organization of American Hosiery?

A. Yes.

Q. What?

A. Well, there, again, Mr. Adler got the idea of starting the American Hosiery Mills and asked me to help him formulate a company.

Q. Was that a partnership, or a corporation?

A. It was a partnership.

Q. What was the nature of the hosiery business of the American Hosiery Mills?

A. They bought hosiery and sold it direct to the consumer, door to door, through representatives, but differed in their method from Realsilk Hosiery Mills in that they did not have branch offices to supervise their sales people.

Q. Now, the American Hosiery Company was a merchandising or a sales organization?

A. Well, it was a sales organization, I think, primarily.

Q. Did it buy hosiery in the grey?

A. Yes, it bought hosiery in the grey and arranged to have it finished and packaged under their name.

Q. Did the American Hosiery Company own the stock in a hosiery corporation?

A. No.

Q. It didn't own any stock in a hosiery mill?

A. Yes, it owned the stock of the Artesian Processing Company, which did a partial finishing and packaging operation for them. They bought their hosiery in the grey from the Fulton Hosiery Mills, sent it to the National Hosiery Mills to have it dyed. That is in Indianapolis. And they then transported it to Martinsville, Indiana, where they had formed the Artesian Processing Company, which did boarding pairing inspecting, and packing of the hosiery, which in turn it delivered to the American Hosiery Mills in Indianapolis, putting it in its stock ready to fill its order with and sell to the consumers.

Q. It was sold to the consumers by mail?

A. The solicitors were employed by mail, the orders came in by mail, and the orders were shipped by mail directly to the solicitors or their representatives.

Q. You spoke of the Fulton Hosiery Mills. Was that a corporation, or a partnership?

A. That was originally a partnership.

Q. Did you have anything to do with the formation of that partnership?

A. I did.

Q. What?

A. My brother and I owned some stock in a hosiery mill in Philadelphia, the name of which was the Trio Hosiery Mills, which liquidated, after we were in it for perhaps a couple of years. And we took the machinery of that plant, the full fashion machinery, in satisfying our preferred stock investment in it, and moved that machinery to Indianapolis and caused the Fulton Hosiery mills to be formed, which employed that machinery to knit hosiery with. Then the Fulton Hosiery Mills sold out—

Q. What kind of an operation was that?

A. It was just a grey operation.

Q. What kind of hosiery did it manufacture?

A. It made full fashion hosiery.

Q. Were those machines the single unit, or double unit?

A. They were double unit machines.

Q. When you speak of double unit, what do you mean?

A. It means there is one machine that makes a leg of a stocking, and then there is another machine that makes a foot of the stocking. The leg is first transferred to the footing machine, which knits on a fot. So that is called a two-unit operation.

Q. Different machines are used in the process, one machine knitting the leg and the other knitting the foot?

A. That is right.

Q. Now, was that machinery subsequently converted into a single unit operation?

A. Some years later.

Q. Did Fulton have a finishing plant?

A. No.

Q. Did it do any merchandising?

A. No.

Q. And to whom was its grey goods sold?

A. They were sold to American Hosiery Mills.

Q. And finished as you a while ago described?

A. We arranged to get it finished, and sold it.

Q. Now, what disposition did you make of your interest in that partnership?

A. That was given, I think, either to the trusts or my wife. I don't recall at this time. That was many years ago.

Q. You disposed of it?

A. I disposed of it.

Q. In 1937, did you own any personal interest in the American Hosiery?

A. No.

Q. Did you own any interest in Fulton in '37, any personal interest?

A. No.

Q. Did you have any personal ownership or interest in National?

A. No.

Q. Now, when you left Realsilk, you say, in April 1937, when did you get back into the hosiery industry, if you got back?

A. In the fall of that year.

Q. What were you doing in the interim?

A. Well, my brother and I purchased some machinery, which was to be installed in Grenada Industries and leased.

Q. You mean, that was between April and October 1937?

A. Yes.

Q. Did you become associated with the National Hosiery Mills, or National as we call it in the record here, at any time?

A. Yes. In about the summer of that year, or fall—I forget which—I went to Europe, and when I came back I became associated with National.

Q. In what capacity?

A. In a financial capacity, helping on the financial problems.

Q. Did you become an officer of National?

A. I think that in the fall of that year I became either Assistant Treasurer or some officer. I am not certain what it was.

Q. Now, when was the Grenada Industries, Inc. formed; what we speak of here in the record as "Industries".

A. I think December 1937.

Q. Did you participate in the organiaztion of that company?

A. I did.

Q. And in what manner? Will you tell us, please, sir?

A. As a member of the Executive Committee of the Grenada Industries.

Q. Where was its operation to be located?

A. Grenada, Mississippi.

Q. From what State did it obtain its charter, if you are familiar with that?

A. Mississippi.

Q. It is a Mississippi corporation?

A. Yes.

Q. Now, did the City of Grenada make any inducement for you to locate the mill there? Did it hand out any inducement?

A. Yes. It furnished the ground and the building in which the machinery was to be installed at a very nominal rental, I think.

Q. Did you have a contract with this city?

A. Yes, Grenada Industries had a contract with the city, where I think the rental was supposed to be very nominal providing a certain payroll was maintained over a period of time.

Mr. Littleton:

If your Honor please, I thought I had a copy of the agreement here, but I will refer to it in the testimony later on.

By Mr. Littleton:

Q. Now, who were the original stockholders of the industries, Mr. Goodman? How was the stock subscribed?

A. It was subscribed chiefly by various trusts, and I think that Mr. Henry Kobin's wife subscribed to some of the shares, and I believe that Mr. Barskin personally subscribed to some of the shares.

Mr. Ponder:

If the Court please, I would like to move to strike that question and answer, on the grounds that it does not comply with the best evidence rule. I am sure that there must be better evidence; that is, as to how the stock was subscribed, and what portions. I don't think that is competent evidence in that form.

Now, if a foundation is laid to show that there is no better evidence, then I think of course he would be competent to testify of his own personal knowledge such as it was, but I don't believe sufficient background has been laid at this time for secondary evidence.

The Court:

Mr. Littleton, do you think you can supply more—

Mr. Littleton:

Yes. I can offer into the record the written evidence of the original subscription. If you will let it be stricken, we can strike the question and answer at this time, and I will get it in in the proper manner.

The Court:

All right.

By Mr. Littleton:

Q. When did Industries commence business, Mr. Goodman?

A. I think it started operations in January or February, 1938. It might have been December 1937. It is according to what you call "when they started business"; because in starting a hosiery mill you have to install machines and erect them.

Q. Was there an agreement between yourself and J. A. Goodman and the Industries with reference to the machinery with which it began operation?

A. There was.

Q. Will you explain to us, if you will, the arrangement you had and what was the type of machinery that it started business with?

A. The stockholders of Grenada Industries didn't have sufficient money to enable it to purchase the machinery that it would need; so my brother and I purchased the machinery as partners ourselves and leased that machinery to Grenada Industries on the basis that it was to be paid out of depreciation.

Q. Is that the original of the agreement which was made at that time?

A. Yes, that is the agreement.

Mr. Littleton:

I would like to have that identified as Petitioner's Exhibit 26.

The Clerk:

Marked for identification; Exhibit 26.

(Petitioner's Exhibit No. 26 was marked for identification.)

By Mr. Littleton:

Q. What type of machinery, Mr. Goodman, was installed?

A. It was a new type of machinery to make a single-unit type of stocking, making the whole stocking at one operation.

Q. Was that type of machinery manufactured in this country?

A. No. It was imported from Europe.

Q. Was it regarded as being efficient or non-efficient machinery?

A. Well, it was regarded as being efficient machinery and machinery which should make an improved product.

Q. What was the gauge of that machinery?

A. Some were 45 gauge and some were 51 gauge.

Q. Was that the standard gauge in use at that time?

A. Yes.

Q. When did you say that that machinery, then, began operation, with reference to the production of hosiery?

A. Approximately January or February 1938; maybe in December of 1937.

Q. Was that the machinery that was being used by Industries during these periods we have under consideration here?

A. Yes.

Q. Is it still in use?

A. Yes.

Q. Does it belong to the corporation, or to yourself?

A. The corporation owns it. They eventually acquired all the machinery.

Mr. Littleton:

I would like to offer in evidence, your Honor, this agreement that has been identified as having been entered into on the eighth day of January, 1938, as Petitioner's Exhibit No. 26.

Mr. Ponder:

No objections by respondent.

The Court:

Admitted.

The Clerk:

Admitted in evidence; Exhibit 26.

(Petitioner's Exhibit No. 26 was received in evidence.)

By Mr. Littleton:

Q. Now, what type of hosiery, Mr. Goodman, did Grenada Industries produce?

A. Silk hosiery in the early years. Just prior to the war it produced some nylon hosiery, and then during the war it produced, like all mills, rayon hosiery.

Q. Did it have a finishing mill in connection with its operation?

A. No. It had no facilities for finishing hosiery. It was strictly a mill making hosiery in the grey.

Q. What connection, if any, did you have with the formation of the Grenada Knitting Mills Company?

A. Well, my brother and I realized that since the Grenada Industries manufactured hosiery in the grey, its hosiery would have to be finished and marketed by some one, and we saw in it the opportunity for a company such as the Grenada Knitting Mills, which we helped to form, which would arrange for the finishing and selling and merchandising of the product.

Q. Were you a stockholder or an owner of the Grenada Knitting Mills in any capacity?

A. The trusts of my family were stockholders. I was no stockholder.

Q. Do you know if the stockholders of Grenada Knitting Mills were the same stockholders as those of Industries?

A. They were different stockholders than the stockholders in Grenada Industries in certain instances.

Mr. Ponder:

If the Court please, again,—

Mr. Littleton:

Well, I will have to get the record on that, your Honor. I will withdraw the question and strike the answer.

The Court:

My recollection may be inaccurate, but I seem to recall that in his opening statement counsel said that the stockholders of Industries and Knitting were the same.

Mr. Littleton:

I think it is stipulated that the stockholders of Knitting Mills were identical with those of Industries.

Mr. Ponder:

I don't believe that was stipulated, if your Honor please. I believe it was stated.

The Witness:

May I ask a question on that?

Mr. Littleton:

Well, you are on the witness stand. You are answering the questions.

I think we can cover that, your Honor, by stipulation.

Mr. Ponder:

I believe, your Honor, that probably at the conclusion of today's hearing we can consult together and arrive by tomorrow morning at figures on the Grenada Knitting Mills' corporate ownership. It is just a matter that I don't know about that hasn't come into my possession.

The Court:

We will defer that, then.

Mr. Ponder:

All right, sir. We will endeavor to have that arrived at by tomorrow morning.

By Mr. Littleton:

Q. Are you familiar with the arrangement, if any, that Industries made with another organization for finishing and packing its grey hosiery?

A. Yes.

Q. I hand you here an agreement dated April 12, 138, which purports to be between Grenada Industries, Inc., and National Silk Hosiery Mills, and I will ask you if you are familiar with the signature on those documents.

A. I am.

Q. Who signed that agreement for Industries?

A. Mr. J. B. Perry, president of Grenada Industries, Mr. E. L. Morrow, its secretary, and then J. A. Goodman

for National Silk Hosiery Mills, and Mr. A. Barskin, secretary, National Hosiery Mills.

Q. Are you familiar with the signature of all those gentlemen?

A. I am.

Mr. Littleton:

I would like to have that identified as Petitioner's Exhibit 27.

The Clerk:

Marked for identification; Exhibit 27.

(Petitioner's Exhibit No. 27 was marked for identification.)

Mr. Littleton:

I have a photostatic copy of that which I will submit in place of it.

By Mr. Littleton:

Q. Does that agreement that you have identified as Petitioner's Exhibit 27 deal with the finishing and packaging of the grey hosiery of Industries?

A. It does.

Q. Independent of this agreement, are you familiar with what that arrangement was?

Mr. Ponder:

If the Court please, I believe that that agreement would be the best evidence of whatever arrangement was entered into.

By Mr. Littlton:

Q. I mean, this arrangement makes specific provision for that, doesn't it?

A. Yes.

Mr. Littleton:
I would like to offer that as Petitioner's Exhibit 27.

The Court:
Admitted.

The Clerk:
Admitted in evidence; Exhibit 27.

(Petitioner's Exhibit No. 27 was received in evidence.)

By Mr. Littleton:

Q. Was that agreement provided for there carried out in practice?

A. Yes.

Q. What, if any, charges did National make for finishing that hosiery and packaging it?

A. It made charges which covered its costs of doing the work plus a reasonable profit.

Q. Was that on a unit basis, or gross, or dozen?

A. So much per dozen, according to the style of hosiery and what was required to be done with it.

Q. Did National have a larger finishing mill, beyond its capacity of production? Could it finish a greater quantity of hosiery?

A. Yes, it could finish more hosiery than it itself was producing in its own mills.

Q. Now, the hosiery that was finished by National under this agreement for Grenada: was that hosiery kept separate and apart from the production of National?

A. It was.

Q. In the manufacture of the grey hosiery by Industries, what services were rendered to it if any by Grenada Knitting Mills?

A. Grenada Knitting Mills styled the product, designed the product, arranged to merchandise it and have it sold through the National sales organization.

Mr. Ponder:

If the Court please, at this point I would like to move that the question and answer just given be stricken, on the grounds that there is already in evidence an agreement between Industries and Grenada Knitting Mills, Inc., which, according to the testimony of this witness, embodies the agreement between the parties, whatever that agreement was.

Mr. Littleton:

That is Industries and National.

Mr. Ponder:

I understood him to say Grenada Knitting Mills.

Mr. Littleton:

I said: What arrangement was made between Grenada Knitting Mills and Industries for styling the hosiery it produced.

Mr. Ponder:

That is exactly what I have addressed myself to, and that is as I understand it Exhibit No. 27, which is an agreement between—

The Court:

That is between Industries and National, as I understand it.

Mr. Ponder:

Between Industries and National.

Now, there is also Exhibit 26 in evidence. That is between the Goodmans, J. A. and L. L., and Grenada. And it seems to me that the agreements in evidence are the best evidence of what the parties had agreed to.

Now, if there was an oral agreement over and above, in other words in addition to the written, then I think that ought to come out by proper questions, but I don't think that the testimony as given went to that point of whether there was some further agreement. In other words, I had understood that the agreements were in writing.

Now, if there was an agreement over and above that, then I object to this line of testimony without having the previous foundation laid for such oral agreement if that was true.

The Court:

The agreements that have been thus far introduced, as I understand it, do not relate to participation of Grenada Knitting Mills, which is the subject of the question under consideration.

Mr. Ponder:

No. 27 was between Grenada Knitting Mills and National.

Mr. Littleton:

That was Grenada Industries.

Mr. Ponder:

Maybe I have the wrong number. Let me see if I can correct that, because I might have the wrong number.

Your Honor, it appears that there has been a written agreement entered into between Industries and Knitting, which is not yet in evidence. Perhaps if the question

could be reframed—I still think that there either has to be an oral agreement or a written one.

Mr. Littleton:

I asked what was the business relation, if any, between Grenada Knitting Mills, Grenada Knitting Company, and Grenada Industries, Inc.

By Mr. Littleton:

Q. What services did the Knitting company perform, if any, with reference to the manufacture of hosiery by Industries, if you know?

Mr. Ponder:

At that point, your Honor, I object to that question, because it presupposes some type of an arrangement or agreement between Knitting and Industries, or otherwise Knitting wouldn't be having a business relationship with Industries.

That is why I say that I don't think a foundation has been laid, and we haven't gotten to that point. If there was an agreement that Knitting was to perform some services for Industries, then perhaps this witness can testify as to what that was, if it was oral.

The Court:

Mr. Littleton, suppose we look at it this way: If there was a written instrument which was the foundation for the relationship between Knitting Mills and Industries, perhaps it would be better practice to start with the instrument and then build up from that.

If the understanding between the two organizations is reflected in an oral agreement or in some other manner, perhaps that ought to be established first.

By Mr. Littleton:

Q. Well, was there a written agreement between Grenada Knitting Mills Company and Grenada Industries, Inc.?

A. No.

Q. What was the business relation, if any, that existed between those two organizations?

A. Grenada Knitting Mills undertook to see that the Grenada Industries product would be properly designed, styled, merchandised, and sold, so that all that the Grenada Industries would have to do was to continue to make its hosiery in the grey, which was the business for which it was formed.

Q. Now, did Knitting furnish it any merchandising services in that respect?

A. It did.

Q. Did Grenada Industries have any department or employees or persons that could merchandise its hosiery or style its hosiery?

A. No. No, it did not.

Q. It didn't function in that respect?

A. That is correct.

Q. What connection, if any, did you have with Grenada Knitting Company?

A. I was the merchandising manager of the Grenada Knitting Mills.

Q. Were you an officer of that company, or an employee?

A. I was an employee of it.

Q. Did you hold an executive office?

A. Yes.

Q. Was your brother employed by that company also?

A. Yes.

Q. Now, was there any agreement entered into between Grenada Knitting Mills, Inc. and National Hosiery Mills, Inc.?

A. Yes.

Q. I hand you a paper dated January 14, 1939, which purports to be between the National Silk Hosiery Mills, Incorporated, and Grenada Knitting Mills, Inc., and I will ask you if you are familiar with that document and the names of the persons who signed it.

A. Yes. I am familiar with it.

Mr. Littleton:

May I have that identified as Petitioner's Exhibit 28?

The Clerk:

Marked for identification; Exhibit 28.

(Petitioner's Exhibit No. 28 was marked for identification.)

By Mr. Littleton:

Q. I will ask you if there is attached to that document also a further document bearing date of June 26, 1940, executed on behalf of Grenada Knitting Mills, Inc. and National Silk Hosiery Mills, Inc.?

A. Yes.

Q. Are you familiar with the signatures on that?

A. I am.

Mr. Littleton:

I will have that identified as Petitioner's Exhibit No, 29.

The Clerk:

Marked for identification; Exhibit No. 29.

(Petitioner's Exhibit No. 29 was marked for identification.)

Mr. Littleton:

Your Honor, that is an assignment by Grenada Knitting Mills of its interest in the contract of January 14, 1939 to Hosiery, in this case, Grenada Hosiery.

By Mr. Littleton:

Q. After the signing of that agreement, did Hosiery continue to perform the services that were called for from Knitting under that agreement of January 14?

A. It did.

Q. How long did it continue to render those services?

A. As long as the partnership was in existence, which was, I think, until 1946.

Q. Did it do that during the calendar years '40, '41, '42, '43, '44?

A. Correct.

Q. Covering the fiscal periods as indicated?

A. Yes.

Q. What relations did you personally and your brother, J. A. Goodman, have with Hosiery?

A. We did the merchandising.

Q. Were you employees of that partnership?

A. Yes.

Q. Were you paid a salary for your services?

A. Yes.

Q. What was the underlying reason for the agreement, if you know, between National Hosiery Mills, Incorporated, and Grenada Knitting Mills, as stated in the agreement of January 14, 1939? Do you want to look at that agreement?

Mr. Ponder:

If the Court please, respondent objects to this question, on the ground that the document referred to, the agreement between National and Knitting, is already in evidence, and it sets forth the understanding of the parties.

Mr. Littleton:

I asked him what was the underlying reason that brought that agreement into existence. Of course, we are standing on the agreement, but there was some purpose to bring it into existence.

By Mr. Littleton:

Q. What was the cause of bringing that into existence?

Mr. Ponder:

I have an objection before the Court, Mr. Littleton.

The Court:

Will you restate the question again, please?

Mr. Littleton:

I want to know the underlying reasons and causes which brought on this agreement between National Hosiery Mills, Incorporated, and Grenada Knitting Mills. Of course, the agreement speaks for itself, but what were the reasons that brought it on? What purpose did it serve? And for what purpose was it made?

Mr. Ponder:

Your Honor, I still renew my objection that the agreement speaks for itself, and unless there is some showing that it has to be explained that there are some ambiguous features, for example, I don't think the agreement needs any oral elaboration.

The Court:

I think I will let the witness answer that question.

Mr. Littleton:

Proceed, Mr. Goodman.

The Witness:

It was to get in writing the understanding of how National is supposed to function in the selling of this hosiery on behalf of the Grenada Knitting Mills and how National was to make an accounting to Grenada Knitting Mills for hosiery that it sold for its account.

By Mr. Littleton:

Q. Did that economize in any way on the business relations?

A. Yes.

Mr. Ponder:

If your Honor please, I object to leading the witness.

Mr. Littleton:

I asked him if it did. He can say "yes" or "no". I don't lead him out into anything.

Mr. Ponder:

Certainly it tends to suggest an answer.

The Witness:

Yes, it did serve to economize.

By Mr. Littleton:

Q. In what way?

A. National had a sales organization that had the capacity to take on this added product to sell, and it is customary to make arrangements with some selling agency, and Grenada Knitting Mills had its choice as to whether it wanted to take some selling agency in New York or

Chicago to take on this line or to make arrangements with National Hosiery Mills to do the selling.

Q. Now, did it pay for the services that it employed from National?

A. It did.

Q. Under that agreement?

A. It did.

Q. On what basis?

A. Its cost of selling, plus a reasonable charge for its services.

Q. Was that the customary charge that was made in the industry, if you had employed any one else besides National?

A. It was.

Q. Now, when National sold hosiery for the account of Knitting or Hosiery, what record would it make on its accounting records? What record was made?

A. It would keep an accurate record of all of Grenada Knitting Mills' or Grenada Hosiery Mills' product that it had sold to any customers and would credit the total value of those sales to Grenada Hosiery Mills or Grenada Knitting Mills whenever the sale was made.

Q. Did it make any charge against Hosiery or Knitting for its services?

A. It did. It would have an accounting with Grenada Knitting or Grenada Hosiery to charge them for its sales services.

Q. And would those accounts be settled from time to time?

A. From time to time those accounts would be settled. Usually National Hosiery Mills would make payments on account, if not settlements every four weeks; because the money it would get in from its sales naturally included not only the cost of selling that National had to expend but it included the cost of the hosiery, the hosiery in the grey,

which in turn the Grenada Knitting Mills and Grenada Hosiery Mills entered into, because Grenada Hosiery Mills had to be paid for the hosiery that had been sold.

Q. Now, as to the hosiery in the grey, how would that be paid for?

A. Grenada Knitting Mills or Grenada Hosiery Mills would pay the Grenada Industries for the hosiery in the grey as it would be sold from time to time and would pay them an agreed upon price per dozen, which was considered the market price per dozen for such hosiery in the grey.

Q. Was there a market for grey hosiery at that time?

A. There was.

Q. Is there always a market for grey hosiery?

A. There is always a market for grey hosiery, in that a large part of the hosiery made at all times is sold in the grey.

I should say that of perhaps 500 hosiery mills that are in existence today, five or six hundred, fully two hundred of the mills today regularly sell their hosiery in the grey and only in the grey. It is a separate business in itself.

Q. Going back to the services that Knitting and Hosiery rendered to Industries in the manufacture of hosiery in the grey, did those services have any influence upon the price which it could get for its grey hosiery?

A. Yes. It had a marked effect, in that the services which Grenada Hosiery performed—And if I may, when I refer to Grenada Hosiery, I am also referring to Grenada Knitting Mills, too, but instead of mentioning each company each time I will say "Grenada Hosiery". And Hosiery furnished designs and styles and merchandising ideas that it had from Grenada Industries, incorporated in its hosiery, so that at the end National was enabled to get a higher price for Industries' hosiery than was cus-

tomarily gotten for ordinary hosiery. That enabled, then, Grenada Hosiery to pay Industries top market price for its grey hosiery.

Q. To whom would Industries invoice or bill its hosiery in the grey?

A. To Grenada Hosiery.

Q. In addition to the price to be paid for that hosiery in the grey, were any other charges included in the invoice?

A. Yes. Industries would pass the charge that it had received from National for finishing on to Grenada Hosiery to pay.

Q. So that the arrangement was that Hosiery would refund to Grenada any amount that it had expended for finishing and packing or shipping its hosiery?

A. Yes.

Q. And in addition to that, pay it for its hosiery in the grey?

A. That is right.

Q. Now, from your experience in the hosiery industry at that time, could Industries have sold its hosiery to any other customer at as good a price as it got from Hosiery?

A. At some times yes, and at some times no. The grey hosiery market is peculiar, in that when the demand for hosiery is strong the mills which manufacture exclusively in the grey, such as Industries did, can get a good price for their hosiery, but when the market is slack the first market to weaken is the grey hosiery market, because it represents largely surplus hosiery, in that it is hosiery that has no established brand. When the hosiery market is firm, both brands of hosiery, or branded hosiery, and the so-called nondescript unbranded hosiery, sell actively; but when business slackens off it is always the branded hosiery which is able to sell first and maintain their prices, on account of the reputation of their brands.

So if there is any weakening in prices, it is always on the unbranded hosiery, and much of the grey hosiery which is sold in the country by mills dealing exclusively in the grey goes into the unbranded field. Therefore, by Grenada Hosiery having developed merchandising ideas that could be put into Industries' hosiery and sold by National, it was able to create a brand under which the Industries' hosiery sold and create a repeat business and a market for that brand, to the point where the output of Grenada Industries was always sold.

Since Grenada Hosiery was always able to furnish a market for Industries hosiery, so that it always sold its output, Industries was able to receive and continue to receive top market price in the grey from Hosiery.

Q. What brands, if any, were developed under the merchandising program for the hosiery of Industries?

A. We developed a brand known as Round-the-Clock, which was based upon the idea of making a two-thread, a three-thread, and a four-thread stocking, and to put them in the reverse order a four-thread, a three-thread, and a two-thread stocking, in which we knitted the name in the welt of the stocking, "Morn" or "Noon" or "Nite", Nite being the two-thread stocking to be worn for evening wear, Noon to be the three-thread stocking for afternoon wear, and Morn being a stocking not to be worn in the morning especially but that would be worn more for daytime wear. And it cost virtually no more to make the hosiery this way than it would to make it without the names in the stocking. But the whole merchandising idea enabled the stores to feature it in such a way that they were able to sell these stockings, say, at $1.15 a pair, when stockings made on the same machines by competitors, which didn't have these features in them, would sell at a dollar a pair.

Q. Was that of advantage to Industries in selling its grey hosiery?

A. Yes, it was an advantage to Industries in this way: that Grenada Knitting Mills and Grenada Hosiery Mills, by using their ingenuity in merchandising, were able to price their hosiery higher than ordinary hosiery sold on the market, so that there was a profit for the Grenada Hosiery Mills left over and above their paying a normal price to Industries, or a top price to Industries, for the goods in the grey. There was a larger margin of profit between the grey price and the final selling price which made ample room for Grenada Hosiery to be able to continue to pay top market price to Grenada Industries and still pay National for the cost of selling.

Q. Now, what was the merchandising program of National for its hosiery?

A. National simply sold its hosiery as plain hosiery. It sold its 45 gauge stocking, for example, which cost just as much to make as the Industries stocking. It sold it on a price line that was lower, and it had a business established on that, which was satisfactory to National, that had been running ever since 1928. National had a satisfactory business on its styles of hosiery, and the hosiery that it undertook to sell for Grenada Hosiery Mills was a different line of hosiery, which didn't conflict with the hosiery of its own make that it was selling.

Q. Who was the head of its merchandising department?

A. Mr. Henry Kobin, who was the president of the company and had founded it in 1928 and was the merchandiser of it from the start.

Q. Did Knitting or Hosiery render any merchandising services to National?

A. No, it did not. There were other merchandising services which Hosiery rendered to Industries. I mentioned only one.

Q. What was the other type of merchandising services?

A. Oh, there were several. It styled some of its hosiery with a 2, 3, or 4 knit into the welt of the stocking; so that for example, Sears, Roebuck, which was one of the first customers of Grenada Knitting and Grenada Hosiery, was able to put that stocking in its mail order catalogue and sell it as being the customers' choice of three weights, either a two-thread, three-thread, or four-thread. And along with that we coined the expression "Invisorib Fabric". We designed the stocking in such a way that it would look more sheer than usual, so that the ribs wouldn't show up in the stocking as they ordinarily do. And by featuring that, Sears Roebuck was able to sell that stocking in 45 gauge in its catalogue at a dollar a pair as its best hosiery, under a name which Grenada Hosiery Mills coined for them, called "Beauty film hosiery," as contrasted to 51 gauge or higher gauge hosiery in an ordinary three-thread construction which Montgomery Ward was retailing at that time in competition with them at 89 cents. Yet, due to the merchandising idea furnished by Grenada Hosiery to Sears, which was possible by what we first knit, these numbers that we knit into the stockings in Grenada Industries formed the basis for a merchandising program for Sears, so that they could promote and sell their goods at a dollar a pair, which obviously enabled them to pay Grenada Hosiery Mills more per dozen for the hosiery than if the hosiery had to sell for 89 cents.

There were other things. We would style the color line for an Industries product. We would set up the standards of gradings, which we would require that National maintain on the Grenada Industries product, so that the reputation of this new product would be maintained.

And then I might mention that in the year of 1940, in the early part of the year, when there was a new

development, the first development that came of nylon hosiery, we at the Grenada Knitting Mills, at the Grenada Hosiery Mills, were very close with the duPont Company in having helped them develop nylon hosiery, and when the time came that they started to put nylon hosiery on the market in May 1940, and there was just a limited amount of nylon to be furnished, so that out of 500 hosiery mills no more than perhaps 20 hosiery mills were furnished with nylon yarn so that they could put nylon hosiery on the market, Industries was one of those 20 or even less mills that got nylon yarn from duPont to make nylon hosiery with, and it was especially a valuable service to be rendered to Grenada Industries, in that it was duPont's policy at that time only to furnish nylon yarn to mills which finished their hosiery; and whereas Grenada Industries was only a grey mill, it was only on account of the respect that the duPont Company had for J. A. and L. L. Goodman and in more or less repaying J. A. and L. L. Goodman for having helped the duPont Company in developing nylon hosiery, that they willing to furnish nylon yarn for the Grenada Industries to use, whereas other grey mills didn't get it.

Q. Was that the service rendered to Industries by Knitting and Hosiery?

A. Yes.

Q. Through your employment?

A. That is right.

Q. How was the hosiery of Industries identified when sold to the trade and invoiced in the name of National?

A. Well, of course, considerable of the hosiery was sold directly under the name of and billed directly by Grenada Hosiery Mills to such people as Sears Roebuck and Marshall Field, and so forth. But whenever National sold any under its own name—

Q. You mean under its invoice?

A. Under its invoice.—the hosiery was identified by style numbers. Certain style numbers were exclusively used to identify Grenada's hosiery. Other style numbers were used to indicate National's hosiery.

It was always possible for National, after they made a shipment, to be able to keep accurate records of which hosiery that was shipped to the customer was made by Grenada and which by National.

Q. I hand you, Mr. Goodman, photostatic copies of what purports to be an invoice for hosiery in the name of Grenada Hosiery Mills. Is that typical of the manner in which hosiery would be invoiced to Sears Roebuck?

A. It was.

Q. And also to what other—

A. Marshall Field and many others.

Mr. Littleton:

May I offer that in evidence, identifying it as etitioner's Exhibit No. 30?

The Clerk:

Marked for identification; No. 30.

(Petitioner's Exhibit No. 30 was marked for identification.)

Mr. Littleton:

I would like to offer that in evidence.

Mr. Ponder:

We have no objection, your Honor.

The Court:

Admitted.

The Clerk:

Received in evidence; Petitioner's Exhibit No. 30.

(Petitioner's Exhibit No. 30 was received in evidence.)

By Mr. Littleton:

Q. Now, Mr. Goodman, I will hand you another list of invoices, of various dates, which are made out in the name of National Hosiery Mills. Is that the type of invoice that was used?

A. It was.

Mr. Littleton:

I will have that identified as Petitioner's Exhibit No. 31.

The Clerk:

Marked for identification; Petitioner's Exhibit No. 31.

(Petitioner's Exhibit No. 31 was marked for identification.)

By Mr. Littleton:

Q. In the case of hosiery in that invoice that would be out of the stock of Industries' hosiery, that would give the identification on the invoices? What symbol would identify it as Industries' hosiery?

A. The style number or the description of it on the invoice.

Q. They used different style numbers? The two organizations?

A. Yes. Or different descriptive terms.

Q. Will you call off some of those descriptive terms that appear on the invoices there?

A. Well, for example, here in this top one is listed "51 gauge", which was a signal it was made by Industries, since National didn't have any 51 gauge equipment.

Here on the next one, here, is Style 251. Well, that was designated as a style made in Grenada.

Q. Now, if National had a style number, it would not be similar to Grenada's style number?

A. Correct.

Mr. Littleton:

I will offer that in evidence as Petitioner's Exhibit No. 31.

Mr. Ponder:

No objection.

The Court:

Admitted.

The Clerk:

Admitted in evidence as Exhibit 31.

(Petitioner's Exhibit No. 31 was received in evidence.)

Mr. Littleton:

I just wanted to ask one more question, your Honor. I won't go more than five more minutes.

The Court:

All right.

By Mr. Littleton:

Q. Now, in making up the accounting records of those bills or invoices, what procedure was followed?

Mr. Ponder:

Your Honor, at this point, I don't believe there has been any evidence that Mr. Goodman had any official connection with the accounting phase of the business, and perhaps a later witness could better testify as to that acocunting procedure and technique, simply because I think Mr. Goodman has testified as to the scope of his activities and I don't believe he included accounting.

Now, if it is true that he has, and is qualified, then of course we have no objection whatsoever to his testifying.

Mr. Littleton:

I might ask broadly if he gave any instructions to the Accounting Department.

The Witness:

Yes, as Treasurer of the National Silk Hosiery Mills, I gave the Accounting Department instructions as to how to keep the records so that the accountings would be straight between the various companies.

By Mr. Littleton:

Q. Would you make any instruction with reference to the analysis of the invoices and the separation of the accounts at that time?

A. I gave general instructions to the Accounting Department and to the person that we held accountable for our accounting systems, to see that these would all be properly kept.

Mr. Littleton:

I think we could break off there, your Honor.

The Court:

We will reconvene at 10 tomorrow morning.

(Whereupon, at 5:05 o'clock p. m., Tuesday, October 31, 1950, the hearing in the above-entitled matter was adjourned, to reconvene Wednesday, November 1, 1950, at 10:00 o'clock a. m.)

OFFICIAL REPORT OF PROCEEDINGS.

Filed Nov. 15, 1950.

Before the Tax Court of the United States.

Docket No. 24571, 24640.

Grenada Industries, Inc., National Hosiery Mills, Inc., Petitioner,

vs.

Commissioner of Internal Revenue, Respondent.

Hearing at Indianapolis, Indiana.

Date November 1, 1950.

The Tax Court of the United States.

Grenada Industries, Inc., Petitioner,
vs. Docket No. 24571.
Commissioner of Internal Revenue, Respondent.

National Hosiery Mills, Inc., Petitioner,
vs. Docket No. 24640.
Commissioner of Internal Revenue, Respondent.

Room 216,
U. S. Post Office,
Indianapolis, Indiana.
Wednesday, November 1, 1950.

Met, pursuant to adjournment, at 10:00 o'clock a. m.

Before, Hon. Arnold Raum, Judge.

Appearances:
(As heretofore noted.)

Proceedings.

The Court:
Proceed with the case under trial.

Mr. Littleton:
If your Honor please, the Clerk called to my attention that Exhibits 28 and 29 have not been offered in evidence. They were identified. I now offer them in evidence.

The Court:
They are admitted.

The Clerk:

Admitted in evidence; Exhibits 28 and 29.

(Petitioner's Exhibits 28 and 29 were received in evidence.)

Mr. Littleton:

Your Honor, I think there is a further matter that can be stipulated here with reference to Grenada Knitting Mills, that preceded Hosiery.

I would like at this time to offer in evidence as Petitioner's 32 a copy of the corporation excess profits tax return of Grenada Knitting Mills for its year ending June 30, 1939; and its return for the year ending June 30, 1940, as Petitioner's Exhibit 33.

Mr. Ponder:

If the Court please, as I mentioned to Mr. Litleton, Respondent's position on these retained copies is simply this: Respondent's counsel does not have in his possession at this time the original of these returns. Now, I am not in a position, of course, to agree that these are the copies of the returns as filed. On the other hand, I am not disputing that. I just don't know. That is my position. And so perhaps it would be better if they would be identified by a witness who could say that these are copies of the returns as filed. That is my only point. In other words, I don't have the originals; and, of course, in that situation these would not be the best evidence.

Now, I wouldn't insist on the best evidence rule if these were properly identified.

The Court:

For what purpose are they being offered?

Mr. Littleton:

They show that it was in business and had income and did file returns and discontinued business.

The Court:

Just to show that it was a live corporation?

Mr. Littleton:

Yes.

Mr. Ponder:

For that limited purpose, your Honor, we would have no objection to the fact of the exact figures in the return; though, of course, as to the point of whether those are the figures in the original as filed, I couldn't agree to that. But I would be glad to agree to the reception of the returns in evidence to show that the corporation was in business during that period and filed returns.

The Court:

They may be received for that purpose.

The Clerk:

Admitted in evidence; Exhibits 32 and 33.

(Petitioner's Exhibit 32 and 33 were received in evidence.)

Mr. Littleton:

I also have a Revenue Agent's Report dated April 30, 1943, auditing the return of the Grenada Knitting Mills, Incorporated, for its fiscal period ending June 30, 1940, which I would like to offer in evidence as Petitioner's Exhibit No. 34.

Mr. Ponder:

There is no objection to that, your Honor, by Respondent.

The Court:

Admitted.

The Clerk:

Exhibit 34.

(Petitioner's Exhibit No. 34 was received in evidence.)

Mr. Littleton:

There is another matter I think we could clear up by stipulation, your Honor. It is with reference to the stock ownership of Grenada Knitting Mills, Inc. at September 8, 1939. The amount of stock issued and outstanding was 100 shares, divided into shares held by Sarah Wolfe Goodman, 35; Elliot R. Goodman Trust, 35; William Kobin Trust, for Anne Kobin, 6-2/3 shares; Anne Kobin Trust, 6-2/3 shares; Florence S. Kobin, individually, 6-2/3 shares; and A. J. Barskin, 10 shares.

Mr. Ponder:

Respondent stipulates and agrees with counsel for Petitioner, your Honor, that those are the correct record stock holdings as of the date stated of Grenada Knitting Mills.

Mr. Littleton:

I think maybe that is with reference to William Kobin, the William Kobin Trust, created by Henry V. Kobin, owing 6-2/3 shares, and the Anne Kobin Trust.

Mr. Goodman, will you resume the stand?

Whereupon L. L. GOODMAN, resumed the stand and testified further as follows:

Direct Examination (Continued).

By Mr. Littleton:

Q. Mr. Goodman, at the adjournment of Court on yesterday, we were speaking with reference to the method of accounting that was kept with reference to the merchandise of Industries and the instructions that you had given the Accounting Department in having the invoices for the merchandise analyzed, and it being recorded as the sales of Industries merchandise and the sales of National when made from National merchandise.

Now, who was in charge of the accounting records of National Industries and Hosiery at that time?

A. Well, we had a department head, but at that particular time Mr. C. E. Stevens, who was our adviser on accounting, was instructed by me to see that a proper system was used and installed to keep all the proper records necessary to meet all the requirements that we had at that time, in knowing how much money was due to each company and what the values were and what the expenses were.

Q. So you wouldn't be familiar with the detailed methods, as to how the accounts were kept?

A. No, I looked to Mr. Stevens to work out those details; although he would discuss those with me in general, and I was satisfied with the principles that were being used. Just what detailed instructions he gave to the Accounting Department head at that time, he could testify for himself.

I knew that the problem wasn't a complicated one, and it only required simple instructions, such as seeing that all goods from each different mill had different style

numbers, so that they could reconcile their inventories and their shipments.

It was a different class of hosiery that was being made by Grenada Industries, so it wasn't difficult to determine the proper charges.

Q. Where was the finishing mill of National located?

A. Indianapolis.

Q. Yesterday you were speaking about the different grades and brands adopted for Hosiery Industries that were sold to the trade.

I will ask you: Was that of benefit to merchandising hosiery from its grey products?

And if so, what was the nature of the benefit?

A. It was a benefit to Grenada Hosiery, in that it enabled Grenada Hosiery to sell its hosiery at a higher price than the average hosiery sold.

Q. The Industries products which Grenada was merchandising?

A. Yes, that they were arranging distribution for.

Q. Was that adopting of the different brands of hosiery one of the merchandising services furnished by Hosiery?

A. Yes, it was. And since you asked what benefit it was to Hosiery, I might cite this, for example—

Q. Well, I mean, what benefit to Industries' products, when they went into the trade?

A. I don't understand the question.

Q. The brands were put on the products of Industries, were they not?

A. Yes.

Q. And the merchandising service was furnished by Hosiery?

A. Yes.

Q. Now, what was the benefit of that service in the trade to Industries or to Hosiery or to the trade?

A. It insured a steady sale of the output of Grenada Industries and enabled it to get top market prices for its goods in the grey.

Q. Mr. Goodman, would that enable it to sell to only one store in a town? Or more than one store?

A. Oh, well. The plan which was developed by Grenada Hosiery, and Knitting prior to that, was to enable this higher priced hosiery to find a larger market in the bigger cities, or in the various important cities, through packing this hosiery under different brands. As I have already mentioned, they could sell to more than one store in the town and at the same time give each store they sold to exclusive sale on that brand.

For example, there were three brands on one line of products. One was known as Round-the-Clock. That brand was sold to Marshall Field. Marshall Field does a large business in Chicago. But in the opinion of Grenada Hosiery, it didn't do sufficient volume of business, or couldn't do a sufficient volume of business, on Industries' product, to justify tying up the entire city of Chicago by giving it to just the one store, Marshall Field. Yet, if they sold that same hosiery under, say, the Round-the-Clock brand to other stores in Chicago, Marshall Field wouldn't put any effort at all behind it; might not even handle it. Because it is customary for stores to want exclusive sale of any product that they are going to get behind and advertise. Therefore we created on this same hosiery which we designed the ideas of using the names "Morn," "Noon," and "Nite," and using the numbers 4, 3, and 2; and we designed another brand known as "Airspun," another brand known as "Solitaire," and we sold the Airspun brand to Mandel Brothers in Chicago, which is virtually next door to Marshall Field on the street, and just a block we were able to sell the Solitaire brand to the Fair Store, each one having exclusive sale, all being

basically the same goods; but not even the consumer knew that it was the same hosiery, because it was packed so distinctively. This was an idea that no other hosiery firm had ever used before. It was a merchandising idea created by my brother and me; it had never been used before; it hadn't even been used by National Hosiery Mills before.

Q. Did it work?

A. It worked very successfully and is in effect.

Q. Was there risk taken in that respect in the marketing and merchandising method?

A. Well, there wasn't a risk taken in that respect, because we handled it in such a way that while each store, each of the three accounts in Chicago, or, in Philadelphia, Wanamaker, Gimbel Brothers, and Bonwit Teller, who were the three accounts there, knew that it basically was the same product merchandised by Grenada Hosiery Mills, they knew that it was so packed and so designed that the public would not be able to recognize it as being the same hosiery, and therefore they could claim exclusive sale.

However, since you mentioned the matter of risk, there was a risk that I think is important. And it is one of the reasons why National Hosiery Mills itself was not desirous of taking on this line of hosiery to sell as its own hosiery and wanted it to be known that it was not made by them.

National Hosiery Mills had its own business, which was satisfactory, and its own distribution, which was satisfactory, on an old established product which had been made for years in the orthodox way in the industry, like practically all hosiery was made, which was double-unit hosiery. This hosiery of Grenada

Hosiery Mills, the Grenada Industries' product, was made on a new type of machine; so it produced a new type of stocking. It produced a single-unit type of stocking, where it was not known by the trade whether or not the public would take to it, whether it would be satisfactory, whether it would fit satisfactorily. In fact, just a few years prior, on a machine which was designed to make single-unit hosiery, and where the hosiery was marketed in this country, it proved to be a serious failure, because there was too much fabric over the ankle, and the stocking wrinkled over the instep ankle, so that at that particular time that Grenada Hosiery Mills brought out this new product, or Grenada Knitting Mills, there was a negative attitude in the mind of the retail trade towards any single-unit product, because the previous attempts to make a single-unit product had failed to produce satisfactorily fitting hosiery.

So when Grenada Industries started to make this new product, if it had not been merchandised as it was and designed as it was so as to give satisfaction it might have, according to National's views, reacted unfavorably on National Hosiery Mills, who didn't want to take the responsibliity for this.

There is always the feeling that whenever a new product is on the market it may or may not be satisfactory. That is particularly true every time you try to make an improvement in a knitted product, like in hosiery. There is an old saying in the hosiery industry that for every new advantage that you put into a product, for every new feature you put into it, you usually have two disadvantages that you didn't realize were there coming up. It just so happens that

in the development of this single-unit product, in the very first month of operation, a serious defect occurred in the product, or developed in the product, which for the moment made it appear as though the whole product might be entirely wrong and the reputation of the product would be permanently jeopardized. I have in mind some of the first samples which were sent to Kaufman's Pittsburgh, that were left there by the salesman. Two days later, after the salesman got home, we got a letter from Kaufman's Pittsburgh from the buyer, saying that the first time that these sample stockings were put on by this buyer's secretary or girl in the office, there, a runner developed, in that it broke at the instep point where the foot and leg joined. And this man says, "I don't want any single-unit hosiery. This thing is a failure."

We were quite frightened at that, because we didn't know that there was such a defect. And by my brother giving designing advice to Grenada Industries, they were able to redesign the product to overcome that defect.

I mentioned that to show you that there were risks involved in this new product, and how it was designed and the marchandising of it was important.

Q. This difference of branding and identification in hosiery that was of the same quality in every respect: did that give you wider distribution of the hosiery?

A. Yes, it gave wider distribution. And wider distribution was needed, for this reason: Since this was higher priced product and was going to sell at prices higher than ordinary hosiery, it is a known fact in the

hosiery industry that high-priced hosiery sells in the big cities. In the small towns they are usually interested in price merchandise, because in the smaller towns the fastidious women, who want fashion hosiery and higher priced hosiery, usually go to the big cities and make their purchases there.

Therefore, it was essential to have as wide a distribution as possible through three accounts in a town, instead of one account in a town, on this hosiery, so as to be able to sell the output of the plant in the bigger cities, where they had a logical market. This, I say, was a brand new idea, never developed before by any other hosiery manufacturer.

Q. From your experience in the hosiery industry, are there people who engage in business independently of selling or furnishing merchandising services to mills?

A. Yes, there are.

Q. Is that general in the industry?

A. Yes. There are people who, in New York, set themselves up as stylists, who will arrange clor lines for you, people who will command a fee of ten to twenty-five thousand dollars a year or more to do a marchandising job for you and help you style your lines.

Q. Now, Mr. Goodman, I think you stated yesterday that the Grenada Knitting Mills discontinued its business as of or at June 30, 1940. Could you give us any reason why that was done, what prompted that discontinuance of the business in corporate from?

A. Yes. We, like all business men, try to keep abreast of what the taxation laws are, and when we saw that an excess profits tax was to be in effect, and realized that in an excess profit tax any corporation

which would have a small capitalization such as Grenada Knitting Mills did would have virtually all of its profits taxed away under the excess profits tax, and therefore there would be no incentive to continue in the business; therefore, that business was discontinued, and a partnership was formed.

Q. Did you consult your counsel with reference to that?

A. Yes, we consulted our tax counsel and our general counsel, and they recommended the move.

I would like to add one other thing on the matter of service, if I may, merchandising services.

Q. Yes?

A. We rendered services also along the lines of determining—

Q. You are speaking now of Hosiery?

A. Yes.—of determining how much hosiery should be dyed at a time in each of the colors and carried in stock in order to make prompt shipments. Because while National Hosiery Mills was doing a dyeing and finishing job for Grenada Industries, it made no difference to National Hosiery Mills whether they dyed a thousand dozen or five hundred dozen of a color. They would simply follow the instructions that would be given to them. And since Grenada Industries was not in position to furnish the information to National Hosiery Mills as to how much of each color and how much of each style should be dyed and carried in stock in order to be able to make prompt shipments to customers, since Grenada Industries wasn't in touch with that end of the market, that was a merchandising service that Grenada had to supply.

Q. Now, is Hosiery still in business? Grenada Hosiery, the partnership?

A. No. I don't know whether the Grenada Hosiery partnership has ever been dissolved. I don't think it has. But it is not actively in business any more.

Q. Well, what organization, if any, took over its functions under its arrangements with Industries?

A. The National Association Mills Corporation was formed.

Q. At what time?

A. I am not certain. I think it was 1946 or late 1945, one of those years.

Q. What are its functions now with reference to Industries?

A. It buys all of the hosiery in the grey from Industries and markets Industries' product. Well, I would say chiefly its relationship is that it buys the output of Industries in the grey.

Q. National?

A. Yes, today. Then, also at the time that National Association Mills was formed, it made an arrangment with National Hosiery Mills and bought its complete output in the grey. It also bought the output of Fulton Hosiery Mills in the grey.

Q. Batesville?

A. It also bought the output of Batesville Hosiery Mills in the grey, and also has purchased hosiery in the grey from other mills that were in no way related to them.

Q. How is that hosiery finished?

A. That hosiery is then assigned to both Hosiery Mills in Indianapolis to be finished, and also is assigned to Grenada Industries, which I think in 1946 or so established a finishing plant itself.

Q. Does Batesville have a finishing plant.

A. Batesville does not have a finishing plant. It sells its hosiery in the grey to National Associated Mills, which arranges to have it finished either at Grenada or Indianapolis, as it chooses. At times also National Associated Mill sends its hosiery to outside finishing plants to have finishing done.

Q. Now, does it pay the finishing cost when it is finished at National?

A. It does.

Q. And does it pay the finishing cost when finished at Industries?

A. It does.

Q. And it pays it when it finishes it at any other—

A. It does.

Q. Now, are there in the industry exclusively finishing mills?

A. Yes, there are.

Q. Can you mention any such organization?

A. Well, there is the Bick Dyeing and Finishing Mill in Reading, and there are perhaps half a dozen such finishing plants in Reading, and perhaps half a dozen or more in Philadelphia, and some in New York, such as the Lee Dyeing and Finishing Company.

Q. Has Industries ever adopted a sales organization or acquired a sales organization independant of the services of—

A. No, Grenada has never had a sales organization. I might also say there were times when Grenada Industries had some of its grey goods finished by others than National, in the early days.

Q. That is customary in the industry, isn't it? Having the exclusively finishing mills?

A. Yes, it is.

Q. And the exclusively grey mills?

A. Yes, they are separate division of the hosiery industry.

Q. And merchandising service acquired outside of the corporate organization or the business organization?

A. Yes.

Q. And the sale of hosiery: is that carried on by brokers or merchants?

A. Yes. There are perhaps several hundred selling agents in New York who do nothing but represent hosiery mills, either hosiery mills that have their own finishing plants and do their finishing or who make goods in the grey and arrange to get the goods finished at some finishing plant, and then these selling agents take over the selling job for them.

Q. On the operation of a grey mill, is there any wast material accumulated?

A. Yes, every knitting mill has a percentage of waste.

Q. What is the nature of that waste material, Mr. Goodman?

A. Well, in knitting you must realize that the average knitting machine knits twenty-four stockings at one time. There are twenty-four heads on a machine. There are cones of yarn behind each knitting head, and the machines are supposed to work automatically, first knitting the top of the stocking, then the leg, and then the foot.

Well, on the average a yarn will break in maybe one out of these twenty-four stockings that are being knit. So the rest of the twenty-three stockings are completed on the machine, but that stocking didn't get completed. So the one where the yarn broke may have been knitting right down to maybe the ankle, but since there was no

way of finishing the stocking or completing it in any way, that piece of fabric is taken off and considered as waste.

Q. That would be one section. That would shut down the section?

A. No, the section wouldn't be shut down, but the yarn wouldn't be feeding to it.

Q. Was there a market or an output for that class of material?

A. Yes, as waste, according to the material.

Q. Could that be unraveled? Could the yarn be unraveled from that imperfect hosiery?

A. It used to be that the yarn could be unraveled when hosiery was made by what they call the single-carrier process, which was the same thread of yarn that kept knitting back and forth making the entire leg. But at one stage of the development of the silk hosiery business, and later on followed in nylon hosiery, they found that to get a fabric which would be free of rings, these cross lines, they would have to fit it off three cones of yarn, first one thread going across, and another thread going across from another cone, and another thead from another cone, then repeating the three processes again; so they called that a three-carrier process. And no one knew how to unravel that yarn, because it would get all twisted up on account of coming from three different cones.

However, there was a process developed at a later date that was invented by Mr. Barskin, who developed a machine in the early nylon days for unraveling this three-carrier fabric, so that he could sell the yarn from it.

Q. Is Barskin the same A. J. Barskin, a memeber of the Abar partnership?

A. Yes, he was the operating head of the Abar Processing Company.

Q. Abar Processing Company, rather. Was he previously associated with Realsilk?

A. Yes, he was associated with Realsilk during part of the time when I was there, and had charge of the Salvage Department of Realsilk. By that I mean that hosiery that would come back from the consumer, where they complained that there was a run in the stocking, maybe a run in one stocking and not in the other, would be handled that way. He formed a company of his own. He bought that damaged hosiery from Realsilk, set up an operation of having the hosiery repaired so that it would be wearable again, having it all renovated, redyed, and he then was able to sell it as second grade hosiery in the cheap markets of New York.

Q. Now, previous to the time that National and Industries sold their waste material to Abar, what disposition was made of such material?

A. Oh, they sold it to waste dealers. Maybe the waste might have sold for five cents a pound, maybe twenty cents a pound, according to the material.

Later on, when nylon came on the market, because nylon could be melted down again, the market price on nylon waste went up to 50 cents a pound.

Q. In the early operation of Industries, was there much or little waste meterial?

A. There was considerable waste material.

Q. For what reason? Why was that true, as to Industries?

A. Well, it is the same percentage of waste that there always has been. There is always a percentage of waste.

Q. Would the inexperienced operators have anything to do with that?

A. Oh, yes; and naturally the more inexperenced your operators are, the more imperfect stocking they will have. They may not have dyed the thread on the cone properly or may not have fit it in properly, and, of course, Grenada Industries started with all inexperienced help. They had to be trained.

Q. Well, in operating a grey knitting mill, will there be what is known as imperfect hosiery that is discarded?

A. Yes, there will be imperfect hosiery too. An entire stocking may be made, and after the stocking is made, even in handling it, a pull thread may develop in it, a snag. Or perhaps there may be a false stitch where the stocking is looped in the toe, and a run might start from that. So it would have to be mended up to make it into usable hosiery.

Q. Now, efficiency in operation would diminish the quantity of waste that was produced in the mill?

A. That is right. Every mill tries to keep its percentage of waste down.

Q. There wouldn't be enough waste in any one grey mill, would there, to justify a salvage department, a separate salvage department?

A. No. Practically no mill today makes any attempt to salvage their waste. They usually sell it to waste dealers.

There was a period of time, though, when nylon was very scarce and was selling for, oh, eight, ten, or twelve dollars a pound; so people would be glad to have rewound nylon even though it wouldn't make as perfect a hosiery.

Q. Now, Mr. Goodman, the thread that is reclaimed from this waste hosiery: can that go back into the production of other hosiery?

A. Yes. If, in the rewinding process, they keep the number of knots down to a minimum, which can be done, and could be done by the process that the Abar Processing Company had.

Q. Would there be any deterioration in the yarn produced by the unraveling?

A. No. It would make good hosiery.

Q. Would there be a demand for that reclaimed yarn after it was recovered from the waste hosiery?

A. Yes. There was a very strong demand during the time of the shortage of nylon, in the early years of nylon.

Q. Would that be sold at yarn prices, or would it be under yarn prices, the established yarn prices?

A. It would probobly be sold even above yarn prices, because the nylon yarn was on allotment from the duPont Company, and they couldn't even get the yarn they needed.

Q. Suppose there was a plentiful supply?

A. Then it would sell at lower prices than the first quality yarn.

Q. There would be some defect in it?

A. Yes.

Q. And if the waste were kept free from becoming soiled by the producing mill, would that improve the quality of the yarn that came out of the unraveled goods?

A. Yes.

Mr. Littleton:

I think that is all.

Cross Examination

By Mr. Ponder:

Q. Mr. Goodman, just back there in this last testimony a few moments ago, with respect to the knitting of hosiery in the grey, where it is later finished and then merchandised, there isn't any reason why one company can't successfully combine knitting in the grey, complete finishing, styling, and merchandising and selling, is there?

A. No, if a company is set up that way.

Q. In other words, National Hosiery Mills is set up that way, isn't it?

A. For its particular product, yes.

Q. And does it knit in the grey?

A. It knits, finishes; it does the complete job. Or today it doesn't.

Q. But it did during this taxable period from '40 through '44?

A. Yes, it did on its product.

Q. And had done that since its organization in 1928?

A. No.

Q. Could you state about when it did start performing the complete function of knitting all the way down to placing the hosiery in the hands of the consumer?

A. I think I had better tell you the sequence of it.

Q. Just a minute. I think we would probably make better progress if you wait until I get through asking the question and then answer. Then we won't get a cross current between my questions and your answers.

Mr. Ponder:

If the reporter will just read the last question, we will see if we can be straight on this record.

(The reporter read the question as follows:

"Question: Could you state about when it did start performing the complete function of knitting all the way down to placing the hosiery in the hands of the consumer?")

The Witness:

Some time in the 1930's, '32 or '35.

By Mr. Ponder:

Q. I will as youk this, then, Mr. Goodman. As I understand your previous testmony, you went with National in about 1937; is that correct?

A. That is correct.

Q. Now, was National performing a complete function from the knitting in the grey down to placing the hosiery in the hands of the consumer, in 1937, when you went with National?

A. Yes.

Q. Mr. Goodman, during this taxable period—and when I use that phrase, I mean from 1940 through 1944,—how many children did you have at that time?

A. Two.

Q. What were their names?

A. Elliot Goodman and Sue Goodman.

Q. Could you give the date of birth of each one of those children?

A. Well, one is twenty-seven, and the other is nineteen.

Q. Today?

A. Yes.

Q. Are you familiar with how many children your brother, J. A. Goodman had during this taxable period?

A. Three.

Q. Could you give their names and approximate ages now?

A. Yes. There is a boy twenty-five.

Q. What is his name?

A. Or maybe he is twenty-three. Robert. There is a daughter about twenty-four, Ruth Elaine, and another daughter twenty-two, I think.

Q. What is the name of the daughter who is twenty-two?

A. Jacqueline. She may be twenty-three. I may be a year short on all these ages.

Q. Do you know how many children Mr. H. V. Kobin had during this tax period?

A. Two.

Q. What were their names?

A. William Kobin and Anne Kobin.

Q. Can you give their approximate ages today?

A. Yes. William is, I think, twenty-two, and Anne is nineteen.

Q. Now, Mr. Goodman, was Jacob L. Goodman your father?

A. No, Abraham Goodman was my father.

Q. Was Jacob L. Goodman any relation to you?

A. There was no Jacob L. Goodman. You mean Jacob A. Goodman? He was my brother.

Q. And did he and H. V. Kobin form the Realsilk Hosiery Mills originally?

A. No.

Q. They did not. They were both connected with Realsilk at one time; is that correct?

A. My brother and I founded the Realsilk Hosiery Mills, and Mr. H. V. Kobin was employed about a year or two after it was formed.

Q. And you, as I understand your previous testimony remained in your connection with Realsilk Hosiery Mills after your brother, J. A. Goodman, had left his connection with that company?

A. No.

Q. That is not correct?

A. No.

Q. Well, will you state the fact, then, on that, so that we can have that in the record?

A. The Realsilk Hosiery Mills was formed in 1920 by my brother, J. A. Goodman, and me. He was seven years older then me.

Right after the formation of it—or I might say that in 1919 my brother and I formed the Realsilk Hosiery Mills under the name of Goodman Hosiery Mills, but some time in 1920 adopted the style name of Realsilk Hosiery Mills, while also selling under the name of Goodman Hosiery Mills.

Goodman Hosiery Mills sold to the trade, the retail trade, and Realsilk was a vehicle to sell to the consumer. And then in April 1920, Mr. William Kobin, who was the older brother of Henry V. Kobin, was employed by my brother and me with the right to buy an interest in the Realsilk Hosiery Mills, which I think was incorporated perhaps either in the fall of 1920 or the fall of 1921, so that Mr. William Kobin was in on the early development of the Realsilk Hosiery Mills. At that time, Henry V. Kobin was a student at Textile School in Philadelphia, and while he came out and worked with us during his vacation in 1920, it was 1921 when he came out and took a regular job with us and

later on was allocated some stock in the Realsilk Hosiery Mills when it was formed as a corporation.

Then, in 1928, William Kobin died. At that time, after his death, which was in January 1928, Henry Kobin decided that he wanted to leave the Realsilk Hosiery Mills and start a company of his own, the National Hosiery Mills, inasmuch as he felt he would like to get away from the scene where his brother was so active and he would be reminded all the time of the loss of his brother.

So that is how the National Hosiery Mills got started by Mr. Kobin, who was well qualified, having been a graduate of the Textile School. He was president, general manager, and everything, of that whole company; he ran the whole company. He at that time took Mr. Barskin in as a stockholder, and Mr. Barskin was his assistant on manufacturing problems.

Q. Now, is Mrs. Barskin your sister, Mrs. A. J. Barskin?

A. Mrs. Barskin originally was my sister. She died many years ago.

I might say that when Mr. Kobin started the National Hosiery Mills in 1928, he had intended to make an entirely different type of hosiery, an ingrained type of hosiery, which would mean hosiery which was knit of dyed yarn and required no dyeing. It required no dyehouse. But within a year or so after he was in business, he decided that the market for that type of hosiery was turning out badly, and he was going to have to change to making undyed hosiery and having it dyed in the dye house. Therefore, he made arrangements with the Realsilk Hosiery Mills to do the dyeing of National's product for him, for which the Realsilk Hosiery Mills charged them a fee, for dyeing. Then he did the rest of the finishing and shipping and selling himself.

Q. Now, Mr. Goodman, with respect to your testimony as to different styles of hosiery yesterday—and some of it I might not have exactly accurate, because the testimony was yesterday, and if I am in effor, in any of my statements as to the testimony, I want you to make the correct statement of what the fact is.

Now, is it unusual for a hosiery manufacturer to produce different styles of hosiery? Or is it customary for such a manufacturer to produce only one style?

A. I would say that it is not unusual for a hosiery manufacturer to make several styles of hosiery. But there is a difference between styles of hosiery, using the term "styles of hosiery" to mean different constructions, and having styling features in the hosiery. For example, at the time Grenada Industries started up with imported machinery, making three-thread hosiery, and also making some four-thread hosiery—making two-thread, three-thread, and four-thread hosiery—another hosiery mill started with very similar machinery, an identical make of machinery, in Morgantown, West Virginia, known as the Morgantown Hosiery Mills. And they made a thread-thread stocking and a four-thread stocking. I don't think they made a two-thread stocking. But their stocking was just sold as plain hosiery, and at prices considerably lower at retail, at least one or two price lines lower at retail, than Grenada Industries' products sold for, and the difference was only in the styling of it. It cost no more for Grenada Industries to make it than for Morgantown to make its. But the styling was different; such as having a number in it, or perhaps designing the ankle so that it would fit better, having a heel stay in place. Grenada Industries hosiery was styled in such a way that it fit better.

Q. Then would it be true that the styling of hosiery that was being finished and sold by a company would be restricted by the ingenuity and imagination in design of the men in that company who were in charge of that phase of the work? Is that true?

A. Yes. But the average manufacturer who operated a factory was not qualified to do other than to produce an ordinary product according to standard specifications, where the machine manufacturer would say, "This is the way to knit a stocking."

Q. That is what my question is. It is limited to the ingenuity and imagination of the men, if there are such, in the organization who can conceive of these styling features; isn't that right?

A. Yes.

Q. In other words, if a company did have such people in its employ, then it would be limited, as you have testified, to strict or to ordinary standard merchandise. But if it has men with ingenuity and imagination in design it can be changed?

A. Yes, but it doesn't need that added ingenuity in order to produce a staple product for which there is a profitable market for any mill that wanted to make hosiery in the grey, such as Grenada Industries was designed for and had been organized for.

Q. But I am addressing myself to the different styles which you have testified yesterday had a great deal to do with the increased sales.

A. Yes.

Q. As your styling became more attractive and caught the public's fancy, your sales would thereby increase?

A. And you would get better prices.

Q. You would get better prices for the product?

A. Right.

Q. Now, I want to clear up this point. And I believe that the record is not entirely clear on this.

Did National sell its output entirely by the house-to-house canvassing method, or did it also sell some of its product by the normal merchandising method to stores?

A. It sold its good only one way, and that was to stores.

Q. To stores?

A. It never had any direct-to-consumer selling business. I think where you may be confused is that yesterday I was asked about how the American Hosiery Mills sold its product. It sells it direct to the consumer exclusively. It still does.

Q. I see. Is it true that the hosiery which was marked under the symbols of Grenada Hosiery Mills was also sold exclusively to stores? Is that true, too?

A. Not exclusively. Because Grenada Hosiery sold hosiery to Sears Roebuck, which had a mail order business. At one stage of the game, the hosiery had sold through National, another firm that had sold direct to the consumer—

Q. I will ask you if any of that hosiery marked with the symbols of Grenada Hosiery Mills was sold house-to-house?

A. By one of its customers.

Q. Which one was that?

A. There was a firm called The Farrell Merchandising Company, which was started in Indianapolis and had a brief existence. It was started by a man who was formerly with the Realsilk Hosiery Mills. And when he sold hosiery and other products he bought some of his hosiery from this Grenada product.

Q. That didn't amout to very much in volume compared with the total volume, did it?

A. That is right.

Q. And it didn't last very long?

A. That is right.

Q. So, actually, then, you can testify that the majority, the great majority, of the hosiery marked by the symbols of Grenada Hosiery Mills was sold to stores or other large customers, such as Sears Roebuck?

A. Yes.

Q. Which, of course, are stores.

A. Except that they happen to have used that product exclusively in their mail order business at the time, I believe. At a later date I believe they may have used some in some of the stores.

Q. Now, who was in charge of the sales for National Hosiery Mills during the taxable period? Do you know?

A. Henry Kobin.

Q. Did you have anything to do with the sales work for National during this period?

A. No; other than to—No. You mean in my capacity as an officer of National Hosiery Mills?

Q. Yes.

A. No, my capacity with the National Hosiery Mills was strictly as a financial man, treasurer of the company.

Q. Do you know who the partners were in the American Hosiery Mills, that you referred to in your testimony yesterday?

A. I think Mr. Adler—

Q. What is his full name?

A. Mr. Philip Adler.

Q. Junior?

A. Junior. And I believe a trust for my son Elliot and a trust for my brother's son Robert. It is a matter of record. I don't know. I may be wrong, because that was sixteen years ago or more.

Q. Did you testify yesterday whether you knew who the stockholders of Artesian were? Artesian Manufacturing? Or do you call that Artesian Processing?

A. I think it is Artesian Processing Company. It was a corporation owned completely by American Hosiery Mills, and I don't know who the stock—All the stockholders were with American Hosiery Mills, I think.

Q. With respect to the hosiery which Industries knitted in the grey and shipped then to Indianapolis, on what machinery was that hosiery finished? That is, was it on machinery of National Hosiery Mills?

A. Yes.

Q. Was that grey hosiery intermingled with the grey hosiery that National had knitted?

A. No, it was kept separate.

Q. Was there any other grey hosiery received into the National plant for finishing other than the hosiery it got from Industries and what it knitted itself?

A. Yes, there was hosiery made by the Fulton Hosiery Mills, which was dyed by National Hosiery Mills during part of this period, and another time part of it may have been dyed and finished by National for Fulton Hosiery Mills.

Q. Now, yesterday there was some testimony with respect to an arrangement between Industries and Grenada Knitting Mills, Inc. prior to June 30, 1940. Do you know whether or not there was any oral agreement between Industries and Grenada Knitting Mills

with respect to any services that might be rendered to Industries by Knitting Mills?

A. Yes.

Q. Do you know who made such an agreement?

A. Well, my brother and I made such an agreement with the officers of Grenada Industries.

Q. Whom did you deal with representing Grenada Industries?

A. Well, there was Mr. Perry, who was the president at one time, and later Mr. Solar was general manager and president. I am not sure which periods exactly you are talking about.

Q. Well, I am talking about the period now, say, beginning in early 1938, when Industries first began to get into production, and June 30, 1940.

A. That was with Mr. Perry, the president of Grenada Industries, and Mr. Morrow, the secretary of the company, there.

Q. Do you know whether such an agreement was ever mentioned in the minutes of Industries, Inc., or Knitting Mills?

A. I don't recall.

Q. Can you give us the details of that agreement between Industries and Knitting Mills?

A. Yes, we said that we would see that all the goods that Industries made would have a market at a fair price in the grey, and we would see that this output was distributed in a way which would enable them to have continuous full-time operation; but that we would want them to follow our ideas in designing and styling of the hosiery and make the quantities of each style that we would recommend; and that we also would see that proper arrangements would be made for them to have the goods finished, and that the finishing would be done properly.

Q. Who was to determine what that fair price was that you mentioned?

A. Well, that was by agreement, but there was a fairly well established grey market for hosiery. There are dealers in grey hosiery, who were advertising every week in the knit goods papers. We have so much hosiery to offer on a 45-gauge 30 denier stocking at so much per dozen. It is a well established market. The hosiery usually sells at some price relationship in the grey to the finished market price.

If, for example, finished hosiery were selling at seven dollars a dozen for ordinary unbranded hosiery, and there would be several hundred hosiery agents in New York that were selling hosiery at that price, and if it cost maybe a dollar or a dollar and a quarter a dozen, whatever it is, maybe, to have hosiery finished at a finishing plant like Bick Dyeing Company, or something like that, you deduct that price from the finished price, and you would get about what the grey price ought to be.

Mr. Ponder:

I just had one more question right on this point, Your Honor.

By Mr. Ponder:

Q. Did Knitting Mills own any machinery outright in its own name?

A. No.

The Court:

We will have a short recess.

(Short recess.)

By Mr. Ponder:

Q. Now, Mr. Goodman, were you the treasurer of National during the taxable period?

A. Yes.

Q. As such, did you have the responsibility for the accounting work and department of National?

A. Yes.

Q. Were you also conversant with the accounting department and accounting work required by Industries?

A. I was acquainted indirectly.

Q. You had no direct authority for that?

A. No.

Q. Do you know whether the books and records of Industries were kept in Indianapolis?

A. I don't know.

Q. Now, do you know of your own knowledge whether or not Hosiery had any employees who were not also employees of either Industries or National?

A. I don't recall. I don't think that there were.

Q. Did Hosiery own outright any finishing machines, if that is the correct term for them?

A. No.

Q. Was all of the finishing of Industries' grey hosiery done on machines of National?

A. Substantially so. There may have been some sent to other finishing plants.

Q. Now, isn't it true that it takes merchandising genuis and ideas to sell large quantities of hosiery at a profitable figure?

A. No. A man could be just in the manufacturing business of making a staple product, and if there is a shortage of that product—and usually a man doesn't start into a new mill to start making a product unless there is a demand for it—the very demand is all that

is necessary for an ordinary product. All he needs to be is a manufacturer.

Q. In other words, then, you testify that it doesn't make any difference whether there are any good merchandising ideas utilized in the merchandising and sale of hosiery?

A. I don't agree with that. It does make a difference.

Grenada Industries could and did have a satisfactory profit through being just a manufacturer of hosiery in the grey. It didn't have in its organization a so-called merchandising genuis type that you speak of. It could have gone out and bought it some place and could have taken the risk on the results that it would get from that merchandising guidance, and it might have made substantially more profit. On the other hand, they might have gotten poor merchandising advice. You can't always be assured that if you buy merchandising services it is going to be good advice.

For instance, a mill might hire someone to do a color styling for them and find that this color stylist would have been all right if they were making hosiery to sell in certain classes of trade, but not in the class that particular concern was going to make hosiery for.

Q. Then competent merchandising guidance is important in the final sale of hosiery, isn't it?

A. Yes.

Q. About how long had Mr. J. A. Goodman, your brother, been in the hosiery field?

A. Forty years.

Q. Had both of you spent your entire active business lives in the hosiery field?

A. That is right.

Q. Now, yesterday you testified with respect to the creation of certain styling ideas, as I understood your testimony, such as the Round-the-Clock idea and the use of numbers 2, 3, and 4 idea.

Do you know who personally was responsible for conceiving, for example, the Round-the-Clock idea? Did you do that?

A. Yes, I did that.

Q. Did you also conceive the 2, 3, 4 idea?

A. Well, I did it jointly with my brother. We did it jointly as a team.

Q. Did the Security Trust Company, which at one time was a trustee under certain of these trust agreements, ever do any work in connection with the hosiery business, so far as you know, in the National or in the Hosiery operation? Did they ever send a man over to help you?

A. No. They were trustees at one time for trusts. Outside of that they did nothing.

Q. They didn't take any part in the hosiery business?

A. They had to vote the stock on matters that required their voting.

Q. Did they take any part in the styling or designing of hose?

A. No.

Q. Do you know whether or not Mr. Charles E. Stevens, who became a successor trustee, ever took any part in the designing or styling of hosiery?

A. No, he did not.

Q. Did either one of your children—Elliot is the one I have in mind now. Did he ever take any part during the taxable period in the hosiery business with you?

A. No.

Q. Did your daughter take any active part?

A. No.

Q. Neither one of them had ever had any experience or training in the hosiery field during the taxable period?

A. Correct.

Q. Now, yesterday you testified to being able to secure nylon from the duPont organization during, I believe, the year 1940, when it was scarce in quantity; is that correct?

A. Yes.

Q. That could be obtained by National? By the National Hosiery Mills?

A. National did, yes, for its organization.

Q. Can you state how you were able to obtain nylon at that time, when it was in extreme demand and many manufacturers weren't able to obtain it?

A. Well, first, my brother had a personal relationship dating back to the real silk days with Mr. Ramsdell, who was the head of the Nylon Division, the Nylon Sales Division.

Next, during the development of nylon hosiery, the duPont Company sought out my brother and me; my brother for technical advice on how nylon stockings could be produced more satisfactorily from the standpoint of stitch formation, and how many courses per inch; and they worked with me on the matter of analysis of their markets, as to who would buy nylon hosiery, whether the hosiery should sell for $1.15 or

$1.35, whether the hosiery should be made of 40 denier. I personally conducted tests on the wearing qualities and other problems connected with the nylon hosiery and guided the duPont Company in that respect.

Q. Was the duPont Company grateful for your assistance and expert help, so as to make this nylon then available to National and related companies, rather than to some other companies that it had no such relationship with?

A. National didn't need any help in getting nylon for its plant, because Mr. Kobin, the head of National, had contacted the duPont Company about nylon yarn and nylon hosiery prior to my brother and I even entering into the picture.

Mr. Kobin arranged for his own company, the National Hosiery Mills, independent of my brother and me, to do some development work on nylon hosiery, which qualified them to be on the list of the early mills that would get nylon yarn to its company.

Q. Then who got the nylon yarn that was obtained in that way? Industries got it?

A. No. No, the nylon yarn was furnished to both National, on its own account, and furnished to Industries, based on the request of my brother and me of duPont, on account of special services that we had rendered to the duPont people.

Q. That clears it up. That is what I wanted to find out.

Now, you testified yesterday that in your capacity as treasurer of National, you would hold a certain person responsible for the details of the accounting

system. Who was that person, during the taxable period?

A. Mr. C. E. Stevens.

Q. Do you know approximately when Mr. Stevens entered the employ of National and related organizations?

A. Yes. Mr. Stevens had formerly been with the Realsilk Hosiery Mills, and he started to do some work, I think, for the Fulton Hosiery Mills in about 1932, supervising their accounting, and taking other responsibilities along with it. Then in 1937, when I joined National, I asked Mr. Stevens to supervise the accounting methods and procedures and systems that would be employed by National.

Q. And did he also supervise the accounting system and techniques of Hosiery?

A. Yes.

Q. Was that under your general supervision also?

A. Yes.

Mr. Ponder:

Your Honor, at this time, there is a Joint Exhibit which we desire to introduce into evidence, which is a schedule of trusts and trustees; the trusts having been created by either Mr. J. A. Goodman, Mr. L. L. Goodman, or Mr. H. V. Kobin, and also Mr. Philip Adler, Jr., but although that happens to be on the chart, it is not pertinent in this case. If the Court could give this a simple designation for identification, we will want to introduce that in evidence as a joint exhibit.

The Clerk:

Marked for identification, Exhibit 35-0.

(Joint Exhibit 35-0 was marked for identification.)

By Mr. Ponder:

Q. Now, Mr. Goodman, examining Exhibit 35-0, which I have refered to previously, it reflects that on May 31, 1929, the Elliot R. Goodman Trust No. 1 was created, with you and E. M. Goodman as grantors. You recall that creation?

A. Yes.

Q. And then on July 1, 1940, the Elliot R. Goodman Trust No. 2 was created, and on January 2, 1942, both Elliot R. Goodman Trust No. 3 and 4 were created.

A. Yes.

Q. Mr. Goodman, did you have any advice from anybody with respect to the creation of these trusts, that is, whether it would be a good thing, whether it would save you any taxes, or not, at the time of each creation?

A. Yes.

Q. Who furnished you that advice?

A. Oh, both Mr. Stevens and Mr. Mantell, our attorney.

Q. You have testified previously as to the decision to have the Grenada Knitting Mills cease doing active business on or about June 30, 1940, with a partnership to be created at that time named Grenada Hosiery Mills. Can you state who furnished the advice with respect to the tax incidence thereto on that transaction?

A. Our attorneys and Mr. Stevens.

Q. Do yo urecall why two separate trusts, the ones I referred to, E. R. Goodman Trusts No. 3 and No. 4, were created on the same date, January 2, 1942?

Do you recall why there were two separate trusts created on the same day, rather than one trust?

A. I was following the advice of my attorneys at that time, and I don't recall specifically what the reason was for it at that time. But they had good resons for it at that time, I am sure.

Q. Now, when you testified yesterday and this morning with respect to creation of styles, you mentioned that " 'we' created".

Now, whom do you refer to as "we"? That is, you and who else?

A. My brother and I as a team, for the Grenada Hosiery Mills and Grenada Knitting Mills.

Q. Is there and reason why brand names couldn't be multiplied or increased indefinitely, as required by the trade? In other words, you have testified that you created new brand names so that each store, for example, that you dealt with, in a particular city, would have the exclusive sale of that brand. Now, is there any reason why that process couldn't be carried on as far as required, and you could sell to five, six, or seven, if you had that many good customers?

A. I would have to answer that this way. It would be possible, but it would be inadvisable. And it had never been done before, even to create three brands for one product. For example, in the city of Indianapolis, there is only one brand, Round-the-Clock, because we felt as though the business done with Round-the-Clock at L. S. Ayres is sufficient to get the volume and provide an adequate distribution in Indianapolis. And then there were two at St. Louis and three at Philadelphia, Chicago, and San Francisco. It depends upon the territory and the activity of the store there.

Q. In other words, take San Francisco, where you have three. Now, if the population increases great-

ly and another big store comes into being, and you want to increase and sell it to them, and they want a brand name, you can then afford—

A. No, because unless there is a sufficient volume done on each brand, it involves too much expense in the creation of it, and in the carrying on of the service of it.

Q. Then could you state: Is it the volume limitation that would limit, then, the number of brand names that you would have in one city?

A. No. There are other limitations. While the stockholdings had special features, so that they could be camouflaged under special packings, the very advertisement of these features is such, and it would be distinctive enough, that if you had too many brands being advertised with the same features it robs the uniqueness of the value of any brand. Therefore, judgment has to be required in the distribution as to where you would put three brands, where you would put two, and where you would put only one.

Q. Are your customers in each city—take Chicago—aware that you are selling to other customers in that city under another brand name?

A. The store is; not the consumer.

Q. The stores, then, interpose no objection, as long as they have a separate brand name?

A. Will you repeat that, please?

Q. I say, these stores that you sell it to interpose no objection to your selling to other stores in the same city so long as you identify the sales to the other stores by a different brand name; is that correct?

A. Within limitations, that is correct.

Q. Now, going back to the Industries, the machines that were used there, as I understand your testimony, the first machines that were used when the company

began business were the machines that were owned by you and J. A. Goodman and leased to Industries?

A. That is right.

Q. Now, some time later were new machines added in the Industries plant? Do you recall?

A. Yes. Some years later.

Q. Now, are those the machines that were leased under an agreement with any organization designated the Sulaine partnership?

A. Those are some of the machines.

Q. Were there other new machines than those which were also acquired by Industries?

A. At a later date they purchased additional machinery on their own account.

Q. And do you know of your own knowledge whether those later machines were acquired outright by Industries? Or were they also held by some other organization and leased back to Industries?

A. It was done both ways.

Mr. Ponder:

At this time, I hand to the Clerk a document designated "Partnership Agreement", dated October 14, 1940, which the parties desire to introduce in evidence as a joint exhibit.

Mr. Littleton:

If Your Honor please, that is the original together with all the amendments or modifications that have taken place.

Mr. Ponder:

We will just use one number for easy identification.

The Clerk:
36 P.

The Court:
Admitted.

(Joint Exhibit 36 P was received in evidence.)

By Mr. Ponder:

Q. Now, Mr. Goodman, I show you a document that has been received in evidence as Exhibit No. 27, an agreement between Industries and National. I ask you to examine this document and state, if you can, after examination, the exact method for computation of any moneys to be paid under the agreement between the parties here. In other words, I hand you this document, and I call your attention specifically to Paragraph (4) thereof, which paragraph (4) purports to set out a method of payment. I will ask you to explain, if you can, in your own words, exactly how that payment would be computed.

A. Well, paragraph (4) says:

"The charge for said Second Party's services shall be based upon the schedules of charges which said Second Party shall have in effect throughout the term of this agreement, or any renewals thereof."

Q. Now, what does that mean?

A. That means for services for dyeing, finishing, packing the hosiery.

Q. But how was that charge to be computed?

A. It was computed according to the number of dozens that the services were performed on, and according to the nature of the services performed. On

some history there would be dyeing, and then they would be boarded, paired, inspected, packaged; and on other hosiery they might have certain of those operations performed but not all of them performed.

Q. Now, can you point out from that agreement exactly the method that would be used in arriving at figures which one party would then settle on with the other party?

A. Well, those figures were based upon the cost of operation to National, performing it, plus a reasonable profit, and the check which Grenada Industries had against the reasonableness of those prices with the current prices in the trade for similar services by firms who did job finishing as a busines, taking into consideration any other special characteristics, quality, and special requirements, as they went along.

Q. Try to address yourself more specifically to my question. In that specific agreement, Exhibit No. 27, can you point out, right in that agreement, where it is set out as to the method of arriving at the actual figures which the parties were to settle on?

A. National kept a set of books.

Q. Now, just a minute, Mr. Goodman. I say "address yourself to my question." Can you point it out in that agreement? I don't mean what you did outside. I mean can you show me in that agreement, or show the Court, where the method is set forth?

A. You mean, relating to the charges?

Q. That is right.

A. Well, it says it shall be based upon the schedule of charges which the second parties would have in effect for the various services performed.

Q. Now, does that agreement set forth the charges that the parties are to have in effect? Or does that state what they are?

A. They don't state in detail, because it would vary with the character of the hosiery, and there may be twenty different things done to the hosiery.

Q. Is there any clause in the agreement that says that it can't be set out definitely, but it is to vary? Can you find anything in there that states that?

A. I don't understand the question.

Q. My question is this. You say it would vary—

Mr. Littleton:

If Your Honor please, I think the agreement speaks for itself. There is no issue about the charges being reasonable and fair.

Mr. Ponder:

I think, Your Honor, my position is that, this being an inter-family arrangement, of course it has to be more carefully scrutinized than an arm's length transaction between strangers. My position is, and my reason for examining into this document, that it is the Government's position that under this agreement and the other agreements that were in writing the terms were so vague and nebulous and the details of settlement between these different organizations were so vague and so ambiguous that they didn't have any real meaning, and that they met only what the parties wanted to arrive at when the final settlements were made at the periodic times.

Therefore, I am bringing out from this witness, or trying to bring out, what, if anything, the agreements had in them that would specifically pin down these amounts of payment.

The Court:

I think you can ask the witness to point out everything in the agreement that relates to the charges, and I think you may further ask him, after he has answered, whether there is anything beyond that which he has pointed out, and if you care to pursue it further, you can ask him what the practice has been under the agreement. I think beyond that Mr. Littleton's point is well taken.

By Mr. Ponder:

Q. Then I will withdraw the last question, and I will ask you, Mr. Goodman, if you can point out anything in the agreement other than Paragraph (4) pertaining to the method of settlement between Industries and National?

A. Well, it specifically says what it wouldn't charge for; that it wouldn't charge for storage, and that the charges for services would include the covering for insurance against loss by damage and fire and other types of insurance, and that all such costs that would be entailed by National would have to be included in the charges against Industries.

Q. In carrying out this agreement, do you know of your own knowledge who actually made the decisions then as to what amounts would be used in periodic settlements between Industries and National?

A. Very largely they were determined by agreements between Mr. Solar, who had the responsibility of managing Grenada Industries and was only interested in the success, or record, of Grenada Industries, and in negotiation with me, representing National. I mean, for example, I could illustrate one thing. I recall, for example, that once one of the hosiery which came up from Industries to Indian-

apolis, to National,—Oh, so far as how it was determined, Mr. Ponder? I didn't get what you were talking about. You are talking about the charges for finishing. Those, of course, would have to be approved in agreement between Mr. Kobin, president and general manager of National, and me, in negotiating with Mr. Solar, representing Industries. And I say, for example, just to illustrate this, that at one time we got in a lot of goods from Industries, which we found needed to be mended, mended before they could be finished. And the National organization took it upon itself to mend that hosiery and finish it. They rendered a bill to Industries for the mending operation.

As soon as that bill was received by Mr. Solar at Grenada, at Industries, he hit the ceiling, because he said, "I didn't authorize you to mend these hose. You should have shipped them back to me, because I can mend them cheaper here in Grenada than you can in Indianapolis, because you have union rates in Indianapolis and I have non-union rates in Industries."

Well, every charge was watched that way by Mr. Solar, and there was always a guide, as I said, in what was more or less standard in the trade for the various operations.

Q. Then a transaction such as you have described just then wasn't covered specifically by the agreement, and you worked it out?

A. That is right.

Q. You and Mr. Kobin, representing National, and Mr. Solar, representing Industries?

A. Well, very often, if it had something to do with—I think essentially that is so.

Q. Did Mr. J. A. Goodman ever take any part in those negotiations?

A. Yes, he might have taken part in some negotiations, the same as I did, on behalf of Hosiery, where he was rendering manufacturing services.

Q. Did Mr. Barskin ever take part in any of those negotiations?

A. No.

Q. Would you testify that you are personally familiar with the figures appearing in the Federal income and excess profits tax returns of National and the partnership returns filed by Hosiery and by Abar? Now, my question is: Are you personally familiar with those figures?

A. I was personally familiar with National. And did you say "Hosiery"? At the time they were filed, I mean. I don't have them in my head now.

Q. If you were shown the return and asked to explain any figures appearing therein at this time, that is, the method of arriving at those figures, would you be competent to do so? Or is there some other persons who would be more familiar with those figures?

A. I relied upon Mr. Stevens to audit those before they were put to me for any signatures that I might have to supply.

Q. Did you rely originally on what Mr. Stevens would tell you, then, as to the make-up of the returns?

A. Yes.

Q. Now, this waste product that you testified occurred, which was later reclaimed and sold under the name of Abar Process Company: did that waste occur at the Industries' plant, some of it?

A. Yes.

Q. And did some of it occur at the National plant?

A. Yes.

Q. Did any of it occur in the process where the hosiery which was knitted at Industries was being processed in Indianapolis? Now, during that process, was there any waste which was reclaimed by Abar?

A. There would be damaged hosiery, yes, which might have been ruined to the point where it would have to be sold as waste.

Q. Where does your largest waste occur? At the grey knitting stage, or at late processes?

A. At the grey knitting stage is the largest waste.

Q. Was there any reason why National couldn't have reclaimed this waste that occurred, for example, in its plant?

A. It didn't have the equipment for it, and it didn't have enough waste in its plant to bother with its own. The Abar Processing Company, to make it worth while, had to deal in large volumes of waste, including waste that they purchased from dozens of other hosiery mills.

Q. How much equipment did Abar have? Do you know?

A. They had several rewinding machines.

Q. Isn't it a fact that those machines were just old cast-off machines from National?

A. No, I don't think so. If they were, they may have been used as a base and then rebuilt by Abar to this new process. Some of those machines may have been basically used by National for other purposes; not for this particular purpose, but convertible to this. I mean National may have had machines whereby they rewound good yarn. Or, say, when you knit a stocking there may be a pound of yarn on the cone, and when you get right down toward the end of the cone the knitter would take that cone off the machine,

because it may have only enough yarn on it to finish half of the stocking, and therefore they would take it off. Therefore, National may have had machinery which was designed to just unwind the yarn from the small cones and join it on to the larger cones, and in making the larger cones they may have done some of that. But that is different from salvaging waste.

Q. Those aren't the machines, then, that would be utilized by the process that Abar was engaged in?

A. No.

Q. Do you know about how many machines Abar utilized in the reclaim?

A. No, I don't know.

Q. Who would know that?

A. Mr. Barskin.

Q. Did you have any first-hand knowledge of the reclaiming phase of the business?

A. No. And I don't know, I really don't know, what type of machine was employed, or where those machines came from. All that I know is that Mr. Barskin has invented a process and built the machines or arranged to have them built, and established that business.

Q. Then you didn't have any direct supervisory control over any of the reclaiming work, did you?

A. No.

Q. Actually, then, all you know about that part of it is just what you have heard?

A. That is right.

Q. Do you know, Mr. Goodman, why the sales of the hosiery bearing the Hosiery symbols were billed to Sears Roebuck and Field's on invoices bearing the Hosiery designation, whereas a great number of other sales were on National invoices?

A. Yes. There were a number of reasons, there.

First, Sears Roebuck was interested in buying hosiery which was made in the Grenada plant. They hadn't been buying hosiery from National Mills. The Grenada Hosiery Mills organization, in this particular case, which happened to be me, had sold them this merchandising idea, and we didn't want there to be any confusion between Grenada Hosiery Mills and National Hosiery Mills.

And, as a matter of fact, National Hosiery Mills had sold Sears Roebuck some goods a few years before which Sears Roebuck was not satisfied with, so that Sears Roebuck thought it would be a negative factor if National Hosiery Mills in any way came into the sale of these goods.

So they bought those directly from Grenada Hosiery Mills. When they came to Marshall Field, they were already a customer of National Hosiery Mills, but the buyer at Marshall Field told Mr. Kobin, when he called on him, with this Grenada product, that it was the policy of their stores that they didn't want to buy too much goods from any one firm. Therefore, Mr. Kobin pointed out to him that he could be buying, then, direct from Genada Hosiery Mills.

At the start, in order to keep the products separate, National sold the products direct for Grenada Hosiery Mills to dozens of firms under the name of "Grenada Hosiery Mills". At the same time, they sold those goods to smaller firms who also were using goods from National Hosiery Mills.

At a request of the stores, as time went on—they said it would simplify their bookkeeping if they could

get one bill, rather than these two companies. Because, since it was a high-priced article, maybe there would be a small quantity of this style from Grenada and a small quantity of that from National in its hosiery, in the smaller size accounts in the larger towns or the medium sized towns. And therefore, at their request, National agreed, particularly since by this time the product was on the market and was a proven success, so that National no longer feared risking its reputation in associating with this—they agreed to bill these Grenada goods under National's invoices from then on, but they continued on with Sears and Marshall Field for a much longer time, and perhaps some other large accounts, because they were large users.

Mr. Ponder:

Your Honor, I was about to open up another line of questioning. I don't know just how long that would be, whether we should recess or go into that; whatever your pleasure would be.

The Court:

Suppose you start.

Mr. Ponder:

All right. It might not take very long.

By Mr. Ponder:

Q. Now, back to the merchandising, Mr. Goodman, by National. Did National have a sales organization in the principal cities of the country?

A. They had a sales organization chiefly in New York, which traveled to principal cities.

Q. How was that set up? That is, was it a distinct office in New York and branch offices elsewhere? Or could you describe generally the setup?

A. They had an office in New York.

Q. And did salesmen travel—

A. And also an office in Indianapolis. The salesmen traveled out of there.

Q. Were those salesmen exclusive in the employ of National, or did they also represent other companies?

A. They were exclusive for National. They were salaried employees of National.

Q. Now, beginning in 1940—

A. I am talking about the time when they had the relationship with Grenada Hosiery.

Q. Yes.

A. The arrangements was different prior to 1937.

Q. You are addressing your answer, then, to the taxable period of '40 through '44?

A. Yes.

Q. Now, when hosiery manufactured by Industries was being marketed, would those same salesmen market that hosiery too, that were marketing National's?

A. Yes.

Q. Who supervised the activities of those salesmen?

A. Mr. Kobin, who was General Sales Manager of National. This is true with the exception of the Sears Roebuck business, which was very large, which I personally handled for Grenada Hosiery Mills. I did the selling and merchandising on that.

Q. And the rest of the marketing of the Industries product was done under the supervision of Mr. H. V. Kobin?

A. That is right.

Q. Now, did Hosiery have any separate salesmen in addition to those who were employees of National?

A. None other than me, handling the Sears account.

Q. You were also an officer of National during this period, weren't you?

A. Yes, but my capacity there was limited to financing. I was Treasurer of the company. I had nothing to do with the sales of National.

Q. But you received compensation from National for your services?

A. Yes, as Tresurer of the company.

Q. Now, calling your attention to the date of June 30, 1940, when the agreement was signed under the designation "Grenada Hosiery Mills," do you recall how that amount of money was determined that was to be shown on the books as representing the capital investment of that organization?

A. No; other than that it was to follow in general the pattern of the Grenada Knitting Mills. But there were some substantial changes.

Q. Did you take part in the decision fixing the amount of that capital shown on the books?

A. The matter was discussed with me. I followed the advice, was guided very largely by any recommendations of, my attorney.

Q. You don't recall that you had any independent voice, then, in that determination of the amount?

A. No. That was determined by the trustees for the various trusts and the attorneys.

Q. Well, Mr. Goodman, I call your attention to Exhibit 19 in this proceeding, and particular attention to Paragraph (13) thereof, where it reads:

"The business policy of this partnership shall be determined by J. A. Goodman, Trustee, L. L. Goodman, H. V. Kobin, trustee, and A. J. Barskin, each of whom shall have as many votes as the percentage of interest owned by him bears to the total interests of all partners."

Now, in accordance with that paragraph in the agreement, Mr. Goodman, didn't you participate in all matters pertaining to the policy?

A. I did whatever that agreement indicates there.

Q. But you can't recall that you took any active part in arriving at the initial capital shown on the books; in other words, determining why and how much the business ought to start with?

A. I don't recall. I know that my brother and I were willing to accept the responsibility of management and to enter into the employ of Hosiery for that purpose, and I presume that the Articles were drawn up in such a way that it would insure our management being effective.

Q. Do you know whether Mr. Kobin took any part in that decision?

A. Oh, there is no doubt but what he did. All partners, and those who would be active in it, would naturally be consulted. For instance, his wife was a partner in that business, and she naturally relied upon him for advice.

Q. Well, that was the purpose of your setting out this paragraph (13), wasn't it? So that you and the other three named individuals would have the policy-making power?

A. I presume so.

The Court:

In that connection, I would like to ask the witness a question, if counsel would have no objection.

Would you show the witness this partnership agreement and direct his attention to paragraph (13), which you have just been considering?

The opening sentence of Paragraph (13) reads:

"The business policy of this partnership shall be determined by J. A. Goodman, trustee, L. L. Goodman, H. V. Kobin, trustee, and A. J. Barsin, each of whom shall have as many votes as the percentage of interest owned by him bears to the total interests of all partners."

Now, I notice, if you turn to the opening page of this partnership agreement, that the partners are identified as follows:

"J. A. Goodman, as trustee for Elliot R. Goodman, . . A. J. Barskin, as trustee for Jacqueline Goodman, . . . H. V. Kobin, as trustee for Anne Kobin, . . . and as trustee for William H. Kobin . . . and" (finally) "A. J. Barskin, as an individual."

I don't see anywhere L. L. Goodman referred to as one of the partners in this agreement, and I was wondering what the purpose of having him identified in section 13 was.

The Witness:

I should imagine that inasmuch as I was going to be an important factor in the policy-making decisions

of Grenada Hosiery Mills, I was included as a policy-maker.

Mr. Littleton:

If our Honor please, I think that the document there modifies that and includes Elliot R. in the amendments later on. There are two or three documents there together.

The Court:

I was looking at the original document and not at it in relation to any subsequent amendments; and what puzzled me was that the indenture or agreement of partnership purports to set up a partnership of four partners, and then Section (13) specifies how the business policy of the partnership shall be determined and indicates who shall determine that policy and what weight the determination of each partner shall have.

My curiosity was aroused by the fact that L. L. Goodman is named in Section (13) as having a voice in the partnership in proportion to his percentage of participation, and then in the beginning of the instrument he is given no participation whatever. It seemed to be sort of self-contradictory, and I wondered what the explanation of that was.

Mr. Littleton:

I think that was an oversight and was later amended in another document, following the original. I don't know what the date of it is there.

The Witness:

It will only be effective anyhow if the rest of the partners couldn't agree, and there would be a dif-

ference of opinion. Usually the logic of a situation prevails.

Mr. Littleton:

If Your Honor please, I turn to the next document. It is headed "Modification", dated the twenty-second day of September, 1941. Paragraph No. (13) of said agreement of July 1, 1940, it says, "shall be amended to read as follows." It then provides for that.

The Court:

Let us recess at this point.

(Whereupon, at 12:30 o'clock p.m., a recess was taken until 2:00 o'clock p.m., this same day.)

Afternoon Session.

(The hearing was resumed at 2:00 o'clock p.m,. upon the expiration of the recess.)

The Court:

We will continue with this case, but I will break in at one point for a motion in another case.

Mr. Littleton:

Mr. Goodman, would you come back to the stand?

Whereupon L. L. GOODMAN resumed the stand and testified further as follows:

Cross-Examination (Continued).

By Mr. Ponder:

Q. In your previous testmony, Mr. Goodman, you referred to an Executive Committee. Could you describe that committee in more detail and tell what it is and how it functions?

A. Well, in Grenada, it made the arrangements with the City of Grenada for their furnishing a plant for Grenada Industries.

Q. First, I would have to ask you: The Executive Committee of what? In other words, was it the Executive Committee of Industries?

A. Yes.

Q. Now, who was on that committee?

A. My brother and me.

Q. The two of you?

A. Yes.

Q. Who chose the members of the comittee?

A. The Board of Directors of Industries.

Q. Now, did the Executive Committee have the power to make decisions with respect to contracts of Industries?

A. It was an advisory committee. On certain things it may have had authority to do it, and on certain things not.

Q. Can you describe in detail how far that authority went?

A. Well, I think it went to the matter of making an arrangement with the City for its buildings, making representations to the banks, establishing a line of credit if they needed it.

Q. Did its authority extend to the execution of contracts with other companies for the further processing of Industries—

A. No, that wasn't its function.

Q. It had no function in that regard whatsoever?

A. No.

Q. Did National have a similar executive committee?

A. No.

Q. Did the organization designated Grenada Hosiery Mills have such a committee?

A. No.

Q. It was only Industries that had that Executive Committee?

A. Yes.

Q. During the taxable period, did National have any of its grey hosiery processed by Artesian Processing Company?

A. No.

Q. You are sure that National didn't send any of its hosiery to Artesian to be either finished, dyed, or further processed, at all?

A. I can't recall. There could have been circumstances whereby if the National Hosiery Mills had reached the limit of its capacity in some one department, such as in finishing, say, maybe if it were behind in the Inspecting Department it might have asked the Artesian Company would it perform some of those services for it to help them out on their program.

Q. Did Artesian process any of the hosiery of Fulton Hosiery Company?

A. Yes, it processed most of it, because all that National did was to dye the hosiery for Fulton and then turn it back over to the American Hosiery Mills,

who owned the Artesian Company, and the American Hosiery Mills then had the Artesian Company complete the finishing process for it. But it was no longer Fulton's hosiery when Artesian was doing it. It was the property of American Hosiery Mills, who had bought it in the grey from Fulton.

Q. What were the duties of J. A. Goodman for National?

A. Primarily as manufacturing head. He supervised the manufacturing operations in National.

Q. Now, would that include the manufacturing in the grey and the finishing and dyeing?

A. For National, yes.

Q. For National?

A. Yes.

Q. In other words, that would include supervision of manufacturing from the time the yarn was received down to the time when the finished hose was completed?

A. Yes.

Q. Ready for sale?

A. Yes.

(Short recess.)

By Mr. Ponder:

Q. Now, Mr. Goodman, I show you Exhibit 26, here, which is an agreement between J. A. Goodman and L. L. Goodman, and Grenada Industries, Inc., for the rental of certain machinery.

I ask you whether you, as a member of the Executive Committee of Grenada Industries, Inc., participated in the negotiations leading up to the execution of that agreement?

A. No.

Q. You had no part whatsoever in that?

A. We represented ourselves as the owners of this machinery and dealt with the officers of Grenada Industries.

Q. Can you state who represented Grenada Industries?

A. Mr. J. B. Perry, the president of the company, and Mr. Morrow, the secretary.

Q. Now, referring to the agreement executed between an organization designated the Sulaine Company and Grenada Industries, did you take any part in the negotiations leading up to the execution of that agreement?

A. I don't recall what the agreement was. My memory isn't fresh on it.

Q. I will show that to you, here, to refresh your memory. I believe it is a Joint Exhibit. I don't have the number at hand. This agreement was executed on October 14, 1940. It is Joint Exhibit 36 P.

Mr. Ponder:

I believe, Your Honor, that this is the partnership agreement of Sulaine, and not the agreement for the use of machinery, so I will withdraw that question, and I will ask the witness whether he knows whether or not there was a written agreement executed between the Sulaine Company and Grenada Industries, Inc. for the use of machinery?

The Witness:

I think there was.

By Mr. Ponder:

Q. Can you recall whether or not you took any part in the negotiations leding up to such an agree-

ment either on behalf of Industries or on behalf of the Sulane organization?

A. I don't recall. As I recall it, originally the Sulaine Company had bought machinery that it was planning on installing in Indianapolis, and at the suggestion which was initiated by Mr. Solar inducements were made to have that machinery installed into Grenada.

I don't think that J. A. and L. L. Goodman, in their capacities as an Executive Committee of Grenada Industries, had any part in the negotiation for that.

Q. Did you have any part in the negotiations representing the Sulaine Company?

A. In so far as there were trustees for trusts in Sulaine which had purchased the machinery, yes.

Q. Then you did take part in some of the negotiations?

A. Yes, but not in the capacity of Executive Committee of Grenada Industries.

Q. Now, Mr. Goodman, I show you Exhibit 28, an agreement between National and Genada Knitting Mills, Inc., executed on January 14, 1939, and I call your attention, particularly, in that document, to Paragraph (2) which pertains to expenses incident to the filling of orders between those two companies.

Now, I ask you to read over Paragraph (2) of that document and explain exactly how those expenses were to be pro rated between the companies and who was to make the decision as to how they were prorated?

A. It says:

"All expenses incident to the filling of such orders shall be prorated between the parties hereto in accordance with the expense incident to the shipping of such parties' merchandise."

A system of accounts had been set up which kept a strict accounting of all the expenses which were incurred, and any expenses which were incurred on behalf of the Grenada Knitting Mills' goods were charged to Grenada Knitting Mills.

Q. In case of dispute as to what expenses were incident to one of the two organizations, do you know who was to make the decision as to how that was to be prorated?

A. Well, there usually were no disputes in that sense, in that certain formulas were set down which were obviously equitable.

For example, it says you pro rate the expense. As an example, if a hundred dozen goods were shipped or a thousand dozen in a certain day, and three hundred dozen of those were Grenada Knitting Mills goods and seven hundred were National's goods, then 30 per cent would automatically be charged against Grenada Knitting Mills. I should say that Mr. Stevens would be called upon to adjudicate those differences, as someone who was accountable for the systems that we used for equitable distribution of expenses.

Q. Can you point to any paragraph in that agreement designating Mr. Stevens to make the adjustment in case of controversy? Can you examine that agreement now and point to that paragraph?

A. No, his name isn't in here.

Q. Can you point to any paragraph in that whole agreement giving everybody the right to make the determination in case of dispute?

A. No.

Q. Can you point to any paragraph in there pertaining at all to the proration of expenses, other than paragraph (2)?

A. Well, Paragraph (3) says that:

"The party receiving any remittance in payment of any such merchandise so billed shall hold that part of such remittance (remittances) respresenting payment of the merchandise of the other party in trust. . . ."

This all depended upon the system which was set up originally at my direction, as Treasurer of National, to see that a system was established by Mr. Stevens to properly allocate all expenses. And that was more or less by verbal agreement.

Q. In other words, then, it is necessary to go outside and beyond that written agreement to arrive at the amounts which were to be reported on the returns of each of these companies as expenses and on the books and records of the company; isn't that right?

A. No, I would say that under paragraph (2), where it says the expenses were to be prorated, that would be a covering agreement.

Q. Can you point to any formula in paragraph (2)?

A. There is no specified formula. The books of accounts of the company would be a formula in itself; a record of expenditures.

Q. But there is no formula in that agreement?

A. No, not spelled out.

Mr. Ponder:

No further questions at this time on cross-examination, Your Honor.

I would like to make this statement, however, that of course, I am unaware as to exactly what the identity is of the other witnesses who will be called in this proceeding by the Petitioner.

Now, there are certain matters that I feel, from the examination of this witness, other witnesses are more competent to testify with respect to.

Therefore, at this time I am not going to further cross-examine Mr. Goodman on those matters which I feel other witnesses will be more competent to testify with respect to.

I want to make the statement, though, that certain people whose names have been mentioned in the testimony of Mr. Goodman I assume will be called, and if they are not called, I would reserve the right to recall Mr. Goodman for further cross-examination, if that meets with the convenience of the Court.

Mr. Littleton:
That is perfectly all right with us.

The Court:
Do you have any redirect, Mr. Littleton?

Mr. Littleton:
Just a few questions.

Re-Direct Examination.

By Mr. Littleton:
Q. In your cross-examination, Mr. Goodman, you were asked about the finishing processes of the grey hosiery, and reference was made to the machinery used in the finishing processes. Wil you give us briefly a resume of what the operations of a finishing mill consist of, in the sense that it is finishing hosiery?

A. Well, in some terms finishing is considered dyeing and finishing, and in others dyeing is considered a separate operation from finishing. You can send your hosiery to a dye house that will dye hosiery and return it to you and let you finish it, just the same way as, say, American used to send its Fulton hosiery to National and have them dye it, and then they would send it to Artesian to do a finishing operation. Now, I presume you mean the finishing operation—

Q. Let's have the finishing processes that National rendered in connection with the grey hosiery of Industries.

A. Well, first it dyed the hosiery. After dyeing the hosiery, in machines that are like laundry machines, rotating machines, there was no other machinery required for finishing other than certain steam forms that were the shape of a stocking, that stockings were put on after they were dyed, for the purpose of drying those stockings and helping them hold to the shape to which the stockings had been knit.

For example, if a stocking was size 10-1/2, it would be dried on the size 10-12 leg form. If it were size 9-1/2, it would be dried on the size 9-1/2 leg form.

After the stockings are dried, or boarded as it is called, they are then delivered to a girl who will inspect the stockings, who will look through those stockings to see whether they contain any imperfections. It may be that the stockings has certain imperfections that have come through handling, maybe in dyeing. Maybe she will find the stocking has a ring in it that was due to the faulty yarn that was used. Maybe the stocking was boarded on a size 10-1/2 board and should have been a size 10-1/2, but looking at the foot size, the way it came off, and what the shape of the heel is, the girl would come to the conclusion that this

stocking wasn't a true size 10-1/2, if that is what it was supposed to be, and therefore it would have to go back to reprocessing as a size 10, maybe, instead of a 10-1/2.

After the stockings were inspected to separate the perfect stockings from the imperfect stockings, then another girl would go through a pairing operation. Even though they might be all size 9-1/2 in this particular lot, stockings vary in length by several inches. So she would have to mate up the stockings, getting the short stockings together in pairs and the longer ones in pairs. Because obviously you don't ship out stockings where one stocking is mismated to another. That is a tedious operation. It takes years to train an operator in this pairing operation, because the girl has to learn how to match up the height of the heel and also select the stockings where the heel is the same height as that and also where the total over-all length of the stocking is the same as another stocking, and where the hem of the stocking is the same size. So it has to match up in various sections of the stocking. It requires some years for girls to learn that skill, just as it would take a trained eye to learn how to detect a first quality stocking from an imperfect stocking. The imperfect ones would be sold as irregulars.

As you probably have seen in advertisements of irregulars, a common thing that is said in advertisements of irregulars is that "only a trained expert can tell the difference between the first quality and this irregular." But then, after the stockings are mated up, they go to another operation, where the brand is put on the stocking, with a hot iron. They have to be careful that they don't burn the stocking with it.

Then, after the stockings are branded, they go to another department, where they have to be folded

in a certain way, and a certain skill is employed there, in folding them so that they are put up, say, three pairs in a box, with a certain wrapping around it or band around it. Different kinds of boxes will be used for different brands. Then the stockings would go to a stockroom, where they are segregated in bins according to the style and the size. Later on, when the orders are to be filled, the order pickers would go to these bins and pick out a dozen of this size and a dozen of this size, and a dozen of this color, and so forth, and then they would go to a packing department, which would pack the hosiery in large corrugated containers; so if a customer wanted a hundred dozen hose there would be a hundred dozen in that container, and they would ship that hundred dozen to the customer. And that was called a shipping operation.

Q. Now, in that process there wouldn't be any additional knitting work done on the hosiery?

A. No.

Q. In your cross-examination, you were speaking of your obtaining nylon yarn from the duPonts, and you referred to the fact that you and your brother performed that service on behalf of Industries.

A. On behalf of Industries, yes.

Q. Did you do that individually, or as employees or representatives of Hosiery?

A. We did that as representatives of Hosiery, as a merchandising service to Industries.

Q. Did you and your brother do anything with reference to any of the organizations as individuals, or did you at all times act as the representatives of some one of the organizations?

Mr. Ponder:

If the Court please, I object to that question. That calls for a legal conclusion as to how he was acting; and without more background as to exactly what he did—If he wanted to take it up item by item and state how he was functioning one way or functioning another, he could proceed in that way. But I think that calls for a sweeping conclusion.

By Mr. Littleton:

Q. Whenever you did anything with reference to any of the businesses down there, did you know in what capacity you were acting?

A. Yes.

Q. Did you ever act in an individual capacity?

Mr. Ponder:

I make the same objection, Your Honor, to that question as to the previous one.

The Court:

I think the answer is self-serving.

Mr. Littleton:

He was representing a business. He wasn't representing himself. I just wanted to get that into the picture; that he had no personal interest in any of these organizations.

By Mr. Littleton:

Q. Did you, Mr. Goodman?

A. Other than where I was employed by them.

Mr. Littleton:

That is all I wanted.

Mr. Ponder:

Your Honor, I think counsel has obliterated the effect of that question by putting it into the witness's mouth. If Mr. Littleton wants to tesify, that is all right.

Mr. Littleton:

I didn't know that I led him out. I didn't intend to.

I asked him what whether he acted in any respect as an individual or as a representative of some one of the organizations.

Mr. Ponder:

That is the question to which I made the objection, because I think it calls for a self-serving conclusion.

The Court:

I think if the question were made concrete, it would be more appropriate.

Mr. Littleton:

Well, let me ask this:

By Mr. Littleton:

Q. In anything that you did in connection with the business of National or the services rendered to National or Industries by Hosiery or in connection with any services performed for Industries, did you do that as individuals or as representatives of one or the other of those organizations?

Mr. Ponder:

I made the same objection, your Honor. I don't think it is specific and goes into the item-by-item classification of his duties.

Now, if he wants to take it up in a specific manner, which, as I see it, is the only way the question would have any probative value, I would have no objection.

The Court:

I think he can ask, for example, as to whether Mr. Goodman held himself out.

For example, in dealing with the duPonts, did you make it clear that you were not dealing with them as L. L. Goodman, but that you were dealing with them as a representative of Hosiery?

The Witness:

Correct. It was as a representative of the company.

The Court:

Did they know what company?

The Witness:

Oh, yes. Because they billed their nylon yarn individually to National Hosiery Mills and to Grenada Industries, to both companies separately.

The Court:

But the basis for their making the yarn available to you was not the companies involved but their confidence in you personally, you and your brother; is that correct?

The Witness:

No, the confidence that under our supervision these companies would properly use that yarn to produce good hosiery.

By Mr. Littleton:

Q. Did they know that you were representing Hosiery at the time you dealt with them?

A. Yes, they knew that we were representing Hosiery and that the Grenada Industries was a grey mill that did nothing but grey, and that this hosiery all had to come up to Indianapolis, where it would be supervised—

Q. Did they know that you were rendering merchandising services to Industries at that time, as employees of Hosiery?

A. Yes.

Mr. Littleton:

That is all.

The Court:

I would like to ask the witness a few questions, to help clear up some of my own obscurities.

I understood you to say that Grenada Industries was organized in late 1937, that is, by you and your brother, and that it began operation shortly thereafter. Indeed, a contract was admitted into evidence between Grenada and National that was stated to have been executed in April of '38—that is Exhibit 27—whereby National undertook to, you might say, pick up the pieces where Industries left off.

The Witness:

Finish the hosiery.

The Court:

Finish the product, yes.

Now, the agreement between Knitting Mills and National was dated January 14, 1939, nearly a year later, and that is the first point at which I perceive the entrance of Knitting Mills into the picture. And I would like to know what function Knitting Mills performed in relation to the type of service that wasn't previously taken care of directly between Industries and National. In other words, what function did the interposition of Knitting Mills serve that had not previously been handled directly between Industries and National?

The Witness:

First, there may have been some delay in reducing to writing the formality of the arrangement. Also there was a period of time that elapsed before the hosiery knitted by Grenada Industries in the grey was ready for the market. For example, I don't think that any of the hosiery that Industries knitted in December 1937, as it was setting up a machine—and they were setting up a machine or two a week or a month—I don't believe any of that was ready for dyeing until perhaps March, 1938; so that there was no occasion for a finishing contract prior to that time.

The Court:

My question relates not to the April 1938 contract but rather to the functions performed by Knitting Mills, which first put in its appearance, at least so far as this record is concerned, in January of '39, nearly a year later.

The Witness:

Well, I think that the arrangement up to that time was a verbal arrangement, and always with the un-

derstanding that when it was required, by law or otherwise, it would be reduced to writing, and since all the people dealing with each other understood the plan under which it was to operate, there was no particular hurry in reducing it to writing.

The Court:

When was Knitting Mills organized? When did it commence to function?

The Witness:

I don't recall the exact period. The records would show that.

Mr. Littleton:

March 5, 1938.

The Witness:

It was operating informally, I guess, then.

Mr. Littleton:

As I understood the direct examination of Mr. Goodman—and I will undertake to bring it out; it may not be clear to Your Honor—as soon as this hosiery had been finished under arrangement with National, Grenada Knitting undertook to find a market for that hosiery as its sales organization. It advertised the hosiery, and the record will show that it expended substantial sums of money in testing out the markets.

This agreement of January 1939 between National and Knitting has to do with the use of the sales organization of National for the sale of the Industries-finished hosiery that Knitting was undertaking to per-

form, and the billing of the hosiery from that time forward.

As I understand it, at no time was there any written agreement between Industries and Knitting with reference to its sales and merchandising service.

The Court:

Mr. Goodman, do I understand correctly that neither you nor your brother held stock in Knitting Mills, nor were you partners in Knitting Mills' successor, namely, Hosiery?

The Witness:

Correct. The family trusts held stock, I think you will find the record shows.

The Court:

Did you receive salaries for your services in Knitting Mills and later in Hosiery?

The Witness:

We did in Hosiery. During the early years, probably '38 and '39, of Knitting. I don't think that my brother and I drew any salaries then, because it was all a development operation which was very small, and it wasn't until we had more or less proven our ideas to be valuable, such as we knew they would be, that we received compensation.

The Court:

Was capital a factor in either Knitting Mills or its successor, Hosiery? Or did each of them depend entirely or primarily upon the personal services of you and your brother for their success?

The Witness:

The latter part of your question, I think, is correct.

The Court:

Capital was not a factor?

The Witness:

No, capital was not a factor, although responsibility of parties was. For instance, both the stockholders in Knitting Mills and the partners in Grenada Hosiery were responsible partners; so that if there should have been anything develop which required capital through the product not moving through the normal processes, so that it could be sold to the stores and so that in turn Industries would be able to get paid for its goods so that it could finance itself, then the partners in Hosiery or the stockholders in Knitting would have been and could have been called upon to furnish any additional amount of capital which would have been required.

The Court:

Could you make an estimate at all as to the relationship between the salaries that you and your brother received as against the total profits of Knitting Mills, first, and then Hosiery, second?

In other words, what I am trying to do is this. I am trying to see if we can establish some kind of relationship between the money that was paid you for your services and the remainder that was available for distribution first to the stockholders and then later to the partners in the successor enterprise.

The Witness:

The salaries which were paid us, as I say, in the Knitting Mills in '38 and '39, as I recall, were either negligible or unimportant in relation to the earnings of the company. The time came to Hosiery in the year 1940, and so on, when the plan that we had conceived had blossomed out and proven our point, and then we received substantial salaries. I don't know what they were, but the records would show.

The Court:

Well, would you say that the profits available for distribution to the partners of Hosiery were greater than the salaries that were payable to you and your brother?

The Witness:

I presume they were.

The Court:

Would you say they were much greater?

The Witness:

I don't like to make a statement without having the figures in front of me, because I don't know.

The Court:

I will just tell you what is troubling me, and it may be that there is no reason to be troubled by it. But Hosiery, even if it be taken at face, as an organization of the type that you describe, seems to me to be one that is founded upon, you might say, the genius of the personal service of you and your brother, and not one in which capital is a factor at all; and it therefore would seem rather curious to find the fruits

of the enterprise being distributed, so to speak, to the partners, who may not have contributed very much in relation to the enterprise, whereas a much smaller amount would be given to those who were really responsible for its success.

The Witness:

I think your first statement is a proper description: that it depended largely upon our personal services and not on the capital employed. But I think that you will find that once the success of it was established and the profits were developed in Hosiery, substantial salaries or payments were made to my brother and me, quite substantial ones. So we felt that we were being adequately compensated for our special services.

The Court:

You may wish to submit, and it is entirely up to you whether you do or not, unless counsel ask you otherwise, a statement.

Mr. Littleton:

I think the returns show what compensation was paid.

Mr. Ponder:

I also think, Your Honor that that is set out in detail in one of the exhibits which has already been introduced, the Revenue Agent's Report; which I believe contains a complete breakdown of the deductions claimed by, for example, Hosiery on its partnership returns.

I would also like to state this, that with a subsequent witness on the stand I believe the balance sheets and profit and loss statements will be offered in evidence.

Now, of course, that may not again show in complete detail. I do not mean that they do show in complete detail.

The Court:
Thank you very much.

Mr. Littleton:
The Grenada partnership return, which is Exhibit 91, for the year ending June 30, 1941, shows that salaries and wages in the amount of $82,908.44 were paid. A substantial part of that was paid to Mr. Goodman and his brother for their services. That was out of a total gross income of $302,000, being a net income of $101,000 for distribution. That is, its expenses of doing business were $200,000, including the compensation for services, leaving $101,000 for distribution. And the Commissioner adjusts that by disallowing a $1500 item, which brings up the net income for distribution to $103,000. That is according to the agent's report.

The Court:
Thank you.

Mr. Littleton:
Now, in 1942, the compensation was $20,000 salaries, and other expenses, which would be the sales expense, of $122,000, out of a gross operating profit of $149,000, the total expenses being $147,000, leaving a

net of $2,533.17, which the Revenue Report accepts according to the records.

Then for '43, the salaries were $8,151 out of a gross income of $132,000. The total expenses were $83,000, leaving $48,514 for distribution.

And for '44, there was a gross profit of $93,000, expenses of $51,000, salaries of $8,320; leaving for distribution $55,000.

Mr. Ponder:

I would just like to clear up one thing, Your Honor, that came up and I believe is in doubt, before Mr. Goodman leaves the stand. That is with respect to whether he knows that any additional capital investments were made in the name of Grenada Hosiery Mills after June 30, 1940, when it was purportedly organized.

By Mr. Ponder:

Q. Do you know whether there were any additional investments of capital called for?

A. I don't think there were, but the records would show that. I just don't recall. I don't think it did, though.

Mr. Ponder:

I will tie that in later, when a proper witness is on, Your Honor, and we will bring out the book entries, showing the capital accounts of Hosiery at its inception. I just wanted that testimony to tie in with that.

I have no further questions at this time.

Mr. Littleton:
That is all I want to ask this witness.

(Witness excused.)

Mr. Littleton:
I call Mr. Solar.

Whereupon ISRAEL E. SOLAR was called as a witness and, having been first duly sworn, was examined and testified as follows:

The Clerk:
Have a seat, sir, and state your name and address.

The Witness:
Israel E. Solar, 299 West Twelfth Street, New York City, New York.

Direct Examination.

By Mr. Littleton:
Q. Mr. Solar, will you give us your age?
A. Forty-three.
Q. Where do you reside at this time?
A. In New York City.
Q. For what organization are you now working?
A. For the National Associated Mills, Incorporated.
Q. What is the nature of that company's business?
A. That company purchases merchandise in the grey, contracts for its finishing, merchandises the product, and sells it through its own selling organization.
Q. What is the source of its grey merchandise?

A. It has a number of sources for grey merchandise. It purchases merchandise in the grey from Grenada Industries. It purchases merchandise in the grey from the Batesville Company, from National Hosiery Mills, Incorporated, from Fulton Hosiery Mils, Incorporated, from Struttwear Company of Minneapolis. And there are a few minor sources that I just don't recall that it has purchased from in the past year.

Q. What is your relationship with that company?

A. My responsibilities are largely production control, manufacturing specifications, product development, and service to customers.

Q. Now, previous to the time of your connection with the National Associated Mills, what was your experience in the hosiery industry, beginning with your first experience in that industry?

A. Well, I was hired by the Realsilk Hosiery Mills in 1923 as an order filler.

Q. What was your age at that tme?

A. Sixteen, I think; sixteen or seventeen.

Q. What were your duties with Realsilk?

A. I was hired as an order filler.

Q. An order filler?

A. An order filler, to fill customers' orders from the stock bins and see that they were shipped.

Q. How did you progress with that organization, and where did you progress to?

A. Well, in early 1924, I was put in charge of a certain section of their Shipping Department. Later in 1924 and in early 1925, I was Production Manager for their Lingerie Department.

Q. Lingerie?

A. They were manufacturing lingerie, had just started the department, and I was the Production Manager.

Q. Was that a knitting process? Or weaving?

A. No, that was a cutting and sewing process.

Q. They bought the cloth?

A. They bought the cloth and cut the cloth to various patterns and put it through various sewing operations and pressed them and packaged them and got them ready for shipment.

Q. That was a direct customer operation?

A. Yes, that was largely direct to the consumer.

Q. In connection with what other type of business?

A. Well, their main business, of course, was the manufacture of hosiery.

Q. And was this lingerie sold along with the hosiery direct to the customer?

A. Yes.

Q. Now, from that point, where did you progress to?

A. From that point I became the Assistant Export Manager, and as such it was my job to see that we handled our export business and developed the products that would be necessary to meet that export market. That gave me a certain amount of manufacturing experience, because I came in contact with the technical problems of manufacturing that were involved.

Q. Speaking of export, that would be export to what countries?

A. We exported at that time pretty much all over the world.

Q. And how was it sold? Are you familiar with the method of sale after the export took place, or did it pass out of your hands?

A. No, that was part of the problem that was involved in that. Most of the merchandise that we sold for export was sold to countries where internally in that country it was sold directly to the consumer.

Q. Now, those distributors in these foreign countries distributed direct to the consumer?

A. For the most part.

Q. But the goods would leave your ownership or the ownership of Realsilk when they were put on and shipped for export trade?

A. Yes.

Q. You didn't follow it over as to the other agency over there?

A. Well, in one case, in a sense of the word, I did. In 1926, I went to Mexico.

Q. You were exporting to Mexico?

A. We are exporting to Mexico?

Q. And what services did you perform in Mexico?

A. Well, at that time the agency there was in bad shape financially and owed us a lot of money. And I went down there and in my own personal name took over that agency and operated it from 1926 to 1930.

Q. As your business, your personal business?

A. Well, I had a large interest in that business.

Q. And did you then deal directly back with Realsilk in getting additional goods for sale?

A. Yes.

Q. Was that a corporation, a Mexican corporation, that you were representing? Or was it an individual?

A. It was a Mexican corporation, in my best recollection.

Q. And did it have Mexican stockholders?

A. No. Another man here locally was also a stockholder in it. I think we two were the main stockholders. The Export Manager at the time, it was; a man by the name of Dyer.

Q. When did you sever your connection with Realsilk Hosiery?

A. Well, if you could call that Mexican adventure still a connection, though an indirect one, since I wasn't on Realsilk's payroll at the time, I returned to New York in 1930, where I became the Office Manager of the Trojan Division of the Realsilk Hosiery Mills.

Q. Will you explain to us what the Trojan Division of the Realsilk Hosiery Mills was? And how it functioned?

A. Realsilk Hosiery Mills, under the name "Realsilk", sold directly to the consumer; but a substantial portion of the production of the Realsilk Hosiery Mills was sold to the retail trade under the trade name "Trojan Hosiery Mills".

Q. Was that a corporation, or just a department of Realsilk?

A. As I recall, it was simply a trade name; it was not a separate corporation.

Q. And it sold finished hosiery to what outlets?

A. Well, it sold finished hosiery to retailers and to chain stores and to mail order houses.

Q. Was that under Trojan brand?

A. No, that was unbranded. That is what is considered in the trade as unbranded. They had no brand name of their own. They sold the hosiery either in what was described as neutral packing; or, if the order were large enough, they would put it up under boxes that would be specified by the purchaser.

Q. Putting the purchaser's name on it?

A. His name and label, and so on and so forth.

Q. Now, how long were you with the Trojan Department of Realsilk?

A. I left there in 1937.

Q. Did the Trojan Department of Realsilk sell hosiery for any other organization besides Realsilk?

A. Yes, the Trojan Department sold the hosiery of the National Hosiery Mills for a considerable number of years.

Q. Was that unbranded hosiery at that time?

A. Yes. Yes, it was.

Q. Would that be referred to as plain hosiery?

A. Plain hosiery.

Q. Now, when you severed your connection there, what organization did you become associated with?

A. I became associated with the National Hosiery Mills.

Q. In what capacity?

A. I was the purchaser of their raw materials, which represented a serious problem at the time, because we were operating in a very difficult silk market.

Q. And that was what year?

A. 1937 and part of 1938.

Q. Now, while you were with National, did you have any connection with its production department?

A. Oh, yes.

Q. What experience did you have there?

A. Well, it's traditional in the hosiery industry that any time anything goes wrong on the knitting floor they blame the raw material. So as difficulties were experienced in knitting, in the ordinary course of business, as there always were certain amount of difficulties, they would blame it on the yarn, and then, of course, it would be my job to go out and find out what the facts were, whether it was material or the way the equipment was operating, or personnel carelessness, or just what it was.

Q. How long were you in the Production end of National Hosiery?

A. I was there until, I would say, perhaps May of 1938. I may be wrong about the month. At that time I became active in managing Grenada Industries.

Q. Grenada Industries was located at what place?

A. Grenada, Mississippi.

Q. What was the nature of its operation?

A. Grenada Industries was trying to build up a grey mill.

Q. Now, what functions did you say you took with Industries?

A. Well, starting in 1938 I was General Manager of Grenada Industries and took full charge of its operations and continued in that capacity, becoming President, if I remember correctly, some time in 1940, of the company, and continuing until 1945. I think those dates are right.

Q. Now, when you became associated with Industries, did you maintain your residence in New York, or Indianapolis, or what place?

A. I maintained my residence in New York, although I would say that from 1938 to 1945 a minimum of sixty to seventy per cent of my time was spent in Grenada, Mississippi.

Q. Did you move your family to Grenada, Mississippi?

A. No, sir.

Q. You never moved your family down there?

A. No, sir.

Q. Now, when you took charge of the production of grey hosiery at Industries at its Grenada mills, what arrangement did it have with any concern for disposing of that hosiery, or finishing it?

A. Well, we had an arrangement with Grenada Knitting Mills, which was later changed to Grenada Hosiery Mills, for seeing that all of the output of Grenada Industries was disposed of and that Grenada Industries was paid a fair grey market price for all of its product.

Q. Now, you were there as the manager and representing its production during the time it had relations with Grenada Knitting Mills?

A. Yes, I think so.

Q. Did you participate in those arrangements with Grenada Knitting Mills?

A. Yes, I think so.

Q. Who was the president of Industries when you first became associated as Manager?

A. Mr. Perry was President of Industries; and when you ask the question whether I participated, I may have participated as advising him as to what to do or giving him my views.

Q. Was he an experienced hosiery man?

A. No, he was not.

Q. Did he spend any time at the mill?

A. Yes, but largely from the point of view of a general interest in seeing that the business was operating satisfactorily.

Q. Well, did he consult you with reference to the agreements that he made with National, as you say, and as has been put in evidence here, for the finishing work on Grenada's hosiery?

A. Yes, I think he respected my opinion.

Q. After you became President of Industries, what authority did you have with reference to disposing of its grey goods or making arrangements with others for having it finished?

A. I had full authority.

Q. What arrangements, if any, did you make with National for the finishing work after you became President?

A. Well, we had a peculiar situation in connection with National. We had an agreement with National, and I think it was entered into prior to my being completely

active in what was going on in Grenada Industries, whereby it was agreed between Grenada and National that National would finish, do the mechanical finishing of, Grenada's merchandise. And I was very unhappy with that agreement right from the start, for a numebr of reasons.

Q. Will you give us some of the reasons?

A. Well, the first is that if you will recall, in those days the whole labor situation was in a sort of an uproar around the country. We didn't know what rights labor unions had and what rights they didn't have.

Q. Were you a union mill at Grenada?

A. We were non-union. And I know that I personally was afraid that in spite of all desire on the part of the officers of National Hosiery Mills to comply with that contract, the union at National could stop that corporation from finishing non-union merchandise.

Q. Now, then, after you became in charge of the operatoins of Industries and the production of hosiery in the grey, what duties did you have and what duties did you perform, if any, with reference to fixing the price at which Industries would be paid for its hosiery in the grey state?

A. Well, I don't understand what you mean by the word "duties".

Q. Yes, what did you do in respect to that? What was your responsibility in representing the company?

A. My duty was to get the best price I could for Grenada Industries.

Q. Well, did you always work to that end?

A. Oh, yes. The measure of my ability was the progress of the company.

Q. Well, if you couldn't have gotten what you thought the grey would be worth on the market from National or any other concern. were you free too sell it wherever you could sell the hosiery?

A. I think so. I think so.

Q. Would you have asserted that fact if you had felt that you were not getting a fair price?

A. Oh, yes. I don't think I would have asserted it for some small difference of opinion, but I mean if the difference of opinion were large enough to warrant being dissatisfied with the price that Grenada was getting for its product, I certainly would have.

Q. Did you have full authority to make any agreement that might be necessary to the advantage of Industries with reference to the sale of its hosiery in the grey?

A. Yes.

Q. And the price that it would receive?

A. Yes.

Q. Now, how would the hosiery be handled after its production in the grey? What would be the second step for the hosiery?

A. Well, we would ship the hosiery to Indianapolis. Frem that time on, as far as I was concerned, my interest in that hosiery largely remained one of keeping title to it until we had been paid for it.

Q. And paid for it in what amount? Based upon what?

A. Well, we were paid in this fasion: As the merchandise was sold, we were paid the grey market price for that merchandise, plus any charges that we had incurred as a result of anything that had happened to that hosiery after the point where it had left us.

Q. Did you supervise the charges made by National for finishing service?

A. I was a party to them.

Q. Well, were you familiar with the amount that should be charged for that service?

A. Yes.

Q. Were you overcharging for it?

A. No, sir. We were in one case, I thought.

Q. What would have been your attitude towards National if you felt that you were being overcharged for that service?

A. Well, in one case that I recall, I insisted that an adjustment of that charge be made. And it was made. And in the future that just didn't happen again.

Q. Do you recall what the nature of that charge was?

A. It was a charge for grey mending. They claimed that the merchandise that we had shipped to them required additional work before it was ready for dyeing; and I challenged both the fact and the charge.

Q. What was your reason for challenging that?

A. Well, I just didn't believe it was so, as far as the fact was concerned. And as far as the charge was concerned, I felt that the charge was higher than we could have done the work for in Grenada had the fact been so.

Q. So you wanted it brought back there if there was any mending work to be done?

A. Yes, for two reasons, first because we could do it cheaper, and second because if something was wrong with the goods we wanted to see it.

Q. How would you invoice, make out your bills, for the hosiery or the expenses that you had incurred? How was that handled?

A. Well, we would invoice the merchandise that had been sold, on the basis of the fair grey market price, plus such charges as we had incurred, such as the finishing charges of National, or packing and shipping charges; any charges of that type were added to the fair market price, and that was the price of the hosier.

Q. Who did you invoice that to?

A. We invoiced that to Grenada Knitting Mills to start with, and then to Grenada Hosiery Mills.

Q. Would that in turn be paid you through the Knitting Mills, or the Hosiery Mills?

A. Yes.

Q. Did you have an agreement or enter into an agreement on behalf of Grenada Industries and Grenada Hosiery with reference to the amount that Grenada would be entitled to receive for its grey hosiery in the event the retail market of the hosiery was less than the grey hosiery price?

A. Yes. We had a situation in 1940. We had a peculiar market situation, because nylon had just come in, and everybody was disturbed about what the value of the silk hosiery might be. And as a result of that, I was disturbed that we might continue to manufacture silk hosiery, and the grey market price on silk hosiery might be substantially lower than our cost of manufacturing. So I wanted to be sure that if we continued to manufacture silk hosiery at that time, the least we were going to get out of it was the cost of manufacturing, provided that the price at which the product was sold was at least equal to that.

In other words, there was going to be nothing on top of that until we got our cost of manufacturing.

Q. A fair price for your grey?

A. That is right.

Q. Now, in order to protect Industries against any low price for its grey hosiery, did you insist upon any written agreement being made between Industries and Hosiery as the organization for merchandising its products?

A. Yes, I did insist.

Q. Do you recall when Hosiery was organized?

A. If I remember correctly, it must have been some time in 1940. It may have been earlier than that. I am not too clear on that. You are talking now of Grenada Hosiery Mills?

Q. Yes, Grenada Hosiery Mills.

A. I am not too sure, but I think it was in 1940.

Q. I hand you a document and ask you if that is the original signed carbon copy of an agreement bearing date of June 24, 1940, between Grenada Industries, Inc. and Grenada Hosiery Mills, a partnership. And is that document signed by you as an officer of Industries?

A. Yes, it is.

Q. Who is it signed by a representative of Hosiery?

A. Mr. Barskin.

Q. Was he a member of that partnership?

A. Yes, he was. I think he was. Yes, I am sure he was.

Q. Were your negotiations carried on with Mr. Barskin, or any one else?

A. My negotiation was largely carried on with Mr. L. L. Goodman and Mr. J. A. Goodman. Now, Mr. Barskin may have been in on it, or not, I mean, I wouldn't remember that, at the moment. But I know that I largely addressed myself to those two.

Mr. Littleton:

Will you mark that as Petitioner's Exhibit 37?

The Clerk:

Marked for identification; Exhibit 37.

(Petitioner's Exhibit 37 was marked for identification.)

The Court:

We will take a short recess, at this point.

(Short recess.)

Mr. Littleton:

If your Honor please, Exhibit 35-0 is offered for identification but the Clerk informs me that it was not offered in evidence. May I now make the offer in evidence?

The Court:

It is admitted.

The Clerk:

Admitted in evidence; Exhibit 35-0.

(Joint Exhibit 35-0 was received in evidence.)

By Mr. Littleton:

Q. The agreement you identified as No. 37 purports to bear the date of June 24, 1940. I will ask you if you have any independent recollection as to when that agreement was actually entered into.

A. I don't know that I can remember the actual date, but I know that on the twenty-fourth of June I prepared it and submitted it as representing my idea of the relationship that should exist. And I would guess that within a reasonable time thereafter, perhaps two weeks or three weeks, it was signed and returned to me. I know we had some discussion of it between the time I prepared it and the time it was signed by Grenada Hosiery Mills.

Q. Did you come to Indianapolis in person to discuss the terms of this agreement with the representatives of Hosiery?

A. Yes.

Q. And in that discussion, who represented Hosiery?

A. Well, I talked with L. L. Goodman and J. A. Goodman. That I am sure of. Now, Mr. Barskin may have been in on the discussion. That I don't remember.

Q. You say you yourself prepared that agreement?

A. Yes, sir.

Q. And dictated it? Is that your own composition?

A. Yes, sir. I don't know whether it is a good one or not.

Q. In insisting on that agreement, what purpose did you have in mind with reference to it being beneficial to Industries?

A. I had a number of purposes in mind.

Q. Will you explain to us, please, sir?

A. The first purpose I had in mind, as I explained before, was the situation regarding the doubtfulness of silk hosiery. And I wanted to be sure that if we manufactured silk hosiery we were not going to be married to a grey market price on silk hosiery, because I could visualize where the grey market on silk hosiery would go substantially below its cost of manufacturing. Because any number of mills at that time were manufacturing silk hosiery not because it was profitable but because they wanted to keep their organization together until they could get enough nylon to operate on. That was one objective.

The second objective was that we were flirting with the idea of setting up a finishing department in Grenada and would have done so except for the intervention of the war; and we actually, after the war, did do so.

So that I wanted to be sure that if we set up a Finishing Department we got the price for our merchandise. For that part that was shipped in the grey, I wanted to be sure that we would get the grey price, and for that part that was shipped finished, that we would get the finished price. That was the second purpose.

Q. Article V of the Agreement provides:

"Mills agrees to make available immediately to Industries, upon request, the entire proceeds of sales of Industries' products which Mills receives, less such disburse-

ments as Mills may make in connection with the expense incidental thereto (including such payments as Mills makes to Industries in payment of charges incurred under Article IV hereunder), or such other expenses Mills may incur for the account of Industries in connection with merchandising and finishing. It is agreed by both parties that Mills does not, by so doing, surrender its right to compensation as hereinafter set forth."

A. Well, that is a different angle there. If you will recall, there was a previous agreement that Grenada Industries had made with National, which tied down the title to the merchandise until the actual money for it was received, and it was the purpose of that particular Article to tie down the title to the money. Because you must keep in mind that in the background of my thinking there was always this problem of what would happen in the event that the Union started to dictate to National Hosiery Mills as to what they might or might not do, and where we stood; and we wanted to make sure that the legal identity of that mercahndise always remained in Grenada Industries. Now, whether I did a good job of it or not, I don't know.

Q. Article VI reads:

"For the supervision of the finishing, merchandising, and sale of Industries' products, Mills shall be compensated for its services in the manner set forth in this agreement and according to the following formula: . . ."

Now, what was the purpose of that formula for fixing the compensation of Mills, or Hosiery?

A. As long as we were dealing with just grey goods, other than the silk phase, there wasn't any problem; because there was a known grey market. You could always go out and find out what the grey market was for various constructions and determine what was a fair grey price. But when you got into the situation of where perhaps

some of the merchandise would be finished, I didn't want to set it up as a finishing plant and simply recover my costs. There would be no purpose in setting up a finishing plant for that.

What I wanted to be sure was that if we set up a finishing plant we would not only recover our costs but a fair profit on top of that cost for the finished hosiery.

Q. Did you feel, under that agreement, that you were enabled, as representing Industries, to get the top price, or a fair price, for the grey hosiery, for its hosiery in the grey?

A. Yes. And in the event that we ran into this situation that I feared on silk, we could get more than the grey market price. We could get the total proceeds less the expenses.

Q. And in that event, what arrangement would have been made for the payment of Hosiery for its services provided it continued to render to Industries the merchandising service that Knitting had rendered to it?

A. Well, if the total proceeds on the silk hosiery were only sufficient to cover the manufacturing costs, Grenada Hosiery Mills got nothing.

Q. So there had to be a market for the finished merchandise sufficient to give a fair return for the grey hosiery before it was paid any compensation for its merchandise?

A. That is correct.

Q. Now, in that event, does this formula provide for the parties getting together and determining what would be the fair charge for Hosiery's services?

A. Yes, we did that from time to time quite frequently.

Q. I will ask you if, in your dealings with Hosiery, it ever became necessary for you to invoke the formula of this agreement for the purpose of determining your grey price for hosiery?

A. No, it wored out satisractorily. We always came to an agreement about the price.

Q. Well, did getting nylon yarn aid in eliminating the necessity of that formula?

A. Yes. As a matter of fact, we were very fortunate in that respect. We got a much larger share of nylon yarn in proportion to our total production capacity. I would venture a guess, although I would have no way of proving it, that it was a much larger share, in proportion to our total production capacity, than any other mill in the country.

Q. Did that service come to you through National, or through Hosiery?

A. It came to us through Hosiery.

Q. In representing Industries, with reference to the price that it received for its grey hosiery, what in your judgment—I will ask you this: In your judgment, did that represent a fair price for that hosiery in the grey?

A. Yes, sir.

Q. Did you keep your self familiar with the price of grey hosiery, as to how it was being sold?

A. At all times.

Q. Did you deal with hosiery as an associated related organization, or as an independent organization?

A. Well, as I said, the measure of my ability was the progress of Grenada Industries; and while the Goodmans and I had been very friendly and got along, nevertheless, as far as my interest was concerned, my interest was in getting the most benefits I could for Grenada Industries. Because that was my sole responsibility.

Q. And you would go to bat with them the same as you would go to bat with the stranger?

A. Yes, sir, we have been to bat many times.

Q. Was there any fear in your mind with reference to union labor at National and the non-union labor at

Grenada creating a conflict with reference to the services of National to finish the grey hosiery of Industries?

A. Yes. As a matter of fact, I have never lost my surprise at the fact that nothing happened in that regard.

Q. What induced you to have that anxiety, if you did?

A. Well, it was the temper of the times. In those days there were all sorts of movements on the part of organized labor not to finish or not to work on or not to transport non-union goods; and I always feared that the day would come when National Hosiery Mills as a corporation would be forced to discontinue the finishing of Grenada Industries' goods.

Q. And in that event, what protection did you think you had under this agreement?

A. Well, this agreement definitely fixed the responsibility of Grenada Hosiery Mills, which, as far as I was concerned, from the point of view of operation, was L. L. Goodman and J. A. Goodman, to see that that hosiery was finished, whether by National or John Jones or whoever they got it finished by, but to see that that hosiery was properly finished.

You see, I might explain that you could look at finishing in two ways. There is the physical problem of finishing, dyeing, boarding, pairing, and so on and so forth. That type of work, for example, is done by a number of commercial finishers. But that comemrcial finisher, without supervision, has no interest in your grey goods. They are only interested in how cheaply they can finish it, and they don't care how many firsts you get out of it or how many irregulars you get out of it or how many seconds you get out of it.

Now, that type of commercial finishing can really hurt you if you are in the grey goods business; and we needed

some one who would know how our hosiery was being finished, how to supervise what should be done with it, what care should be taken, what colors it should go into, how much should go into that color, and that phase of finishing, which really is the phase of finishing that requires more know-how than the other.

Q. Did you, yourself, have that experience and know-how?

A. To a degree, but I had problems enough in Grenada.

Q. In the production end?

A. Yes, I had some very serious problems.

Q. Now, were you ogligated in any way to keep your mill running at Grenada? Did you have any obligations to keep your payroll going there at a minimum amount?

A. Yes, we had an agreement with the City to maintain a certain payroll in Grenada, Mississippi. Obviously, in the hosiery business your costs go down at a fantastic rate as your production rises; so that there is a compelling reason to run at top production level.

Q. Did you get a benefit in the way of rentals or the use of buildings if you maintained a minimum payroll?

A. Yes. As a matter of fact, the City furnished both the land and the buildings on an arrangement for a modest rental on condition that a certain basic payroll would be maintained.

Q. Was this the only mill in the city of Grenada, do you know?

A. Other than a couple of lumber mils, this was the only industry at that time, I think, within 25 or 30 miles.

Q. Were you satisfied with the finishing work that was done for you by National?

A. Yes.

Q. With reference to its being first class work?

A. Yes.

Q. Were you satisfied with the charges that it made against you for that work?

A. Yes.

Q. Did you deem those charges to be within the bounds of reason, and fair?

A. Yes, I think they were. But in the final analysis, I might say this: that while I would not have accepted an unreasonable charge for finishing, as contrasted with that other charge for mending grey goods, nor would I have been satisfied to accept an unreasonable charge for packing and shipping, because in the final analysis my interest as far as Grenada Industries was concerned was in the price of the grey goods. Because those prices, whatever they were, we passed along.

Q. Did you understand that the market price of the finished goods had any bearing upon the fixation of the grey goods price?

A. Yes, in a way it does. But it isn't necessarily in a fixed relationship.

Q. Yes. Well, in what way does that bear upon it, would you say?

A. Well, in ordinary hosiery, what is sometimes referred to as specification hosiery, that is, hosiery that meets certain minimum specifications, the grey market price will follow the finished market price to some degree, except for certain market occurrences.

For example, let us say that at this time of the year finished hosiery, which is available for Christmas selling, would bring a better price proportionately than grey market would bring at this time of the year, which couldn't be finished in time for Christmas and would have to be sold next spring. That relates itself to what I call specification hosiery.

When you deal with quality hosiery, that is, hosiery made to special standards, to high quality standards, then the grey market price follows costs, I think, more closely than it follows the selling price of the hosiery.

Let me give you an example of that. We have a contract at the present time in National Associated Mills for the purchase of grey goods. We paid the grey market price for that grey goods in June, July, August, and September of this year. Since that time the costs of manufacture have gone up. We are today paying more for that grey goods than we paid them, but we are not selling it for any more, finished; so on the other hand if the situation were to reverse itself, you might find that you are getting a high price for the finished goods but that you are able to buy the grey goods at a lower price. But the higher the price that you get for your finished goods, the more you can afford to pay for your grey goods and the higher quality standard you can insist upon. I don't know whether that is clear or not, but I have tried to make it so.

Q. Now, the grey goods that you manufactured down there: did you manifacture them with the idea that they would bring the best price obtainable?

A. That is right. We wanted to manufacture the highest quality grey goods so as to get the highest quality grey price.

Q. Are you familiar with the arrangement, if any, that is made for the selling of the finished goods out of the Industries grey goods stock?

A. As long as the merchandise was being sold, so that we knew that the product was disposed of and we got our money, I didn't concern myself very much about that, except as a matter of casual interest, because that was a responsibility of Grenada Hosiery Mills.

Q. You didn't have any sales organization yourself, did you?

A. No, sir.

Q. Were you in a position to establish a sales organization for your finished merchandise after it was finished from the grey state by National?

A. No, sir.

Q. You didn't have any sales department?

A. No, sir.

Q. Do you know whether or not there are concerns in Chicago or in New York or in San Francisco or in St. Louis that you could employ to make sales for you if you had a mind to do that?

A. Yes, sir. There are such.

Q. Did Industries have anything to do with the price at which this merchandise would be retailed or sold to the trade?

A. No, sir.

Q. You were interested only in what price for the merchandise?

A. We were interested only in the fair grey market price for grey mill?

Q. Are you familiar with the different styles or qualities of hosiery that were produced at Industries, with reference to the number of threads?

A. Yes, sir.

Q. How was that prepared for you, that styling? Where did that come from? What source did you get that from?

A. Well, the ordinary course of events would be for Mr. J. A. Goodman or Mr. L. L. Goodman to tell us that they would like a stocking designed this particular way or having this particular feature.

Q. Would they do it individually?

A. What is that?

Q. Who would they be representing when doing that?

A. They would be representing Grenada Hosiery Mills.

Mr. Ponder:

I move that that question and partial answer be stricken, because there again we are getting back to the

same situation that obtained earlier, on Mr. Goodman's testimony. If he testifies in answer to this question, he is expressing a legal conclusion as to who somebody else was representing.

Now, he can testify as to who Industries was being represented by, because he has testified that he was an officer of Industries.

But as to the other party—

Mr. Littleton:

I will srike the question and withdraw the answer and delete it from the record.

By Mr. Littleton:

Q. Article I of the Agreement: does that make any provision with reference to the type of hisiery that will be manufactured?

A. Yes, it does.

Q. What does it say there?

A. It says that Industries will manufacture hosiery to the stage of process known as "in the grey" to the standards and specifications recommended by Mills.

Q. And was that done?

A. That was done.

Q. How often would you receive or demand settlement for your grey hosiery?

A. Well, I don't think that I had any particular organized formula that could be expressed in terms of number of dates. As long as we are getting sufficient money back at the particular time to cover our requirements, our cash requirements, I had no particular objection to whether the terms extended thirty days or forty-five days or sixty days. I don't think I concerned myself too much with that.

Q. Did you keep a close check on your inventory of grey hosiery and your hosiery in its finished state in the possession of National?

A. Well, I had the records available to me at all times.

Mr. Littleton:

If your Honor please, I would like to offer in evidence at this time as Petitioner's Exhibit No. 37 the exhibit bearing that number which has been identified.

Mr. Ponder:

No objection by Respondent, your Honor.

The Court:

Admitted.

The Clerk:

Exhibit 37; admitted in evidence.

(Petitioner's Exhibit No. 37 was received in evidence.)

Mr. Littleton:

I think you may cross-examine.

Cross Examination.

By Mr. Ponder:

Q. Mr. Solar, has all of your active business career been in the hosiery field?

A. No, when I was a boy I worked for Wasson's for a while.

Q. Prior to your entry into business with Realsilk?

A. That is right. Before that I think I worked for my dad, if that accounts for anything.

Q. Since you were sixteen, would you say that your entire business career has been in the hosiery field?

A. No, I wouldn't say that, because there was an interlude during the war, where I manufactured war material, fuses and shells for the Government.

Q. And were those manufactured at Grenada?

A. They were.

Q. In the plant of the Grenada Industries, Inc.?

A. That is right.

Q. Outside of that experience, then, has all of your business experience been in the hosiery field?

A. That is right.

Q. Since you were sixteen?

A. That is right.

Q. Are you related in any way, either by blood or marriage, to either J. A. or L. L. Goodman?

A. No, sir.

Q. To A. J. Barskin?

A. No, sir.

Q. To H. V. Kobin?

A. No, sir.

Q. I believe in your previous testimony you testified that you were with Realsilk from the time you were sixteen until you went with National, except for a possible period when you were engaged in a Mexican—

A. Adventure?

Q. —activity. And you testified in your direct examination as to your relationship with Realsilk, but you were not on the Reasilk payroll at that time.

A. That is correct.

Q. But outside of that period of Mexican activity, you were at all times an employee of Realsilk, down to what year, about?

A. You mean to 1937?

Q. To 1937. Was that the year that you went with National?

A. That is right.

Q. Had you known Mr. H. V. Kobin when you were an employee of Realsilk? Had you ever known him?

A. Oh, sure. Sure.

Q. Had you known Mr. J. A. Goodman?

A. Yes.

Q. Had you known Mr. L. L. Goodman?

A. Yes.

Q. Had you known Mr. A. J. Barskin?

A. Yes.

Q. Had your relationship with them always been on a friendly basis?—

A. Yes.

Q. In your company organization during that period?

A. I would say so.

Q. Had it been generally satisfactory?

A. I don't doubt but what we had twists here and there, but on the whole I think yes.

Q. You wouldn't have gone with National in 1937 if you hadn't been in a happy frame of mind about your previous relationship with them, would you?

A. I had confidence in them, if that is what you mean.

Q. And you thought that they were all skilled in the hosiery field, didn't you?

A. Yes, I had a great deal of respect for their ability.

Q. You thought that under their guiding genius National had bright prospects?

A. Yes, sir.

Q. You felt the prospects were better than those of some other company, perhaps?

A. Yes, sir.

Q. When were you first approached about taking a position with a company with a plant way down in Mississippi and leaving the National organization? Do you recall about when you were approached on that point?

A. Yes. I wouldn't recall exactly the time, but I would say that it was early in 1938, as a result of a few visits that I had made to Genada, first in regard to difficulties that they were having in connection with their production, which obviously was first balmed upon raw material and developed to be a latent weakness in the type of machine that they had. And then I became active in the negotiations, or the arguments, if you want to call them that, that went on between Grenada Industries and the people who had sold the machines.

And from there, without actually being able to give you the date, the total responsibility for Grenada Industries was turned over to me.

Q. Could you say approximately what date that was when those responsibilities at Grenada were turned over to you?

A. My guess would be that it would probably be around May or June.

Q. Well, now, who asked you to go down to Grenada then, earlier, in other words before May or June of '38? Who asked you to go down to Grenada earlier and look into the production difficulties that you described?

A. Well, as I recall it, the first case was as a result of a request by Mr. Clemens and Mr. J. A. Goodman.

Q. Who was Mr. Clemens?

A. Mr. Clemens was the Superintendent of Knitting in Grenada, Mississippi.

That is not correct. May I change that?

It wasn't Mr. Clemens. It was a fellow by the name of Ollie who was Superintendent of Knitting at Grenada. He and Mr. J. A. Goodman both asked that this trouble be investigated, and I went down there and investigated it.

Q. In your employment at National, under whose general supervision did you function? Mr. J. A. Goodman, or Mr. L. L. Goodman, or somebody else?

A. I would say that I don't know that lines were black and white, but I think in general my responsibility was to J. A. Goodman, because I think he was the President of the Company.

Q. And you do know definitely that he requested that you go down to Grenada and look into the production situation?

A. Yes. Yes, he was a party to the request; no question about that.

Q. Were you living at Indianapolis at that time?

A. No, in New York.

Q. You had lived in New York in your association with Realsilk?

A. Since 1930.

Q. And when you went with National, you didn't move your family to Indianapolis?

A. No.

Q. Were your duties with National largely at Indianapolis, or were they largely at New York?

A. Largely at New York. They were connected with the purchase of silk.

Q. I see.

A. New York was the market for that.

Q. Now, referring to the previous testimony with respect to the negotiations between Grenada Industries and Knitting Mills, can you give the approximate date that those negotiations were first entered into?

A. Well, I will try to answer your question, although it is a little ambiguous to me. I will say this: As my responsibility in Grenada Industries grew, they partially grew because of the fact that Mr. Perry had confidence in me. I mean, he had met me and worked with me, and he had confidence in me. And at that time, the relationship between Grenada Industries and Knitting Mills was one where Grenada Industries was supposed to get a fair

market price for its grey goods. Well, it is very obvious that Mr. Perry, who was not versed in the hosiery business, would consult with me as to whether or not the prices that Grenada Industries was getting were fair market prices, and I would give him my views on them.

Q. Do you know of your own knowledge whether or not Industries' product was merchandised by any other organization prior to the time it entered into the agreement with Knitting Mills?

A. Oh, it had to be, yes.

Q. It was. Now, do you know what organization that was? Was that National?

A. No, it was Knitting Mills.

Q. But was there anybody, as I say, before Knitting Mills merchandised the product? Did any other company merchandise?

A. Are you talking about 1938?

Q. In 1938.

A. There wasn't enough merchandise manufactured for it to be a problem. You see, these machines came in starting in December of 1937. During the course of 1938, my guess is that the last machine was not installed in Grenada Industries, installed and running, until some time in September or October of 1938.

In the meantime, these machines were very defective. The production was terrible. And I don't think that the volume of hosiery that came out of Grenada Industries during the course of that year was such that it represented a formalized merchandising policy. I think we would have been glad to take anything.

Q. Well, what happened to that merchandise?

A. That merchandise was sent to Indianapolis, and my understanding of it is that Grenada Knitting Mills then took charge of it, from the time it was shipped to Indianapolis and Grenada was paid a grey price for it.

Q. Now, was this in 1938?

A. Yes.

Q. The latter part?

A. Yes.

Q. Even though you had no formal contract with Knitting Mills, it is your testimony that Knitting Mills did take over?

A. That is my understanding of it.

Q. You don't know, of your own knowledge?

A. I am trying to think of what I can remember in regard to it. Well, all I can remember in regard to it is this, if it helps with it: I know that when Mr. Perry discussed the matter with me, he never talked about National. He talked about Knitting Mills. And I know that at the time that I feared this finishing contract with National, I was assured that Knitting Mills was the one that was taking that responsibility. Now, when it comes to the actual detail of it, I just didn't know. I mean, I just wasn't in a position to know until 1940.

Q. Did you know whether or not Knitting Mills had any machines of its own?

A. Yes, I knew that they did not.

Q. You knew that all of the work that was to come up from Grenada, in other words, all of the grey hosiery, was to be finished on National machines?

A. Yes. I knew it and feared it.

Q. Now, backing up just a moment: When you went down to Grenada, will you state to the Court how you happened then to go from National, in which capacity I understand you went to Grenada first, and then transfer as an officer of Industries? Now, can you trace how you happened to go and who asked you to make the change?

A. Well, you must consider that during that time I wasn't on any so-called formal relationship with anyone that was involved in the business, or in any related busi-

ness. Now, I went down there on the first trip as a result of the request of Mr. J. A. Goodman and this fellow Ollie.

I remember at that time I got into the discussion of the machines themselves. Then I came back to New York, and I discussed the defects in the equipment, then, with the Alfred Hoffman Company. I made another trip down there—and I think that the frequency of this will be fairly well representative, although the months themselves might be wrong—in September of 1938.

And when I came back, I think I took the third trip at the invitation of the machine company and went down there with their representative. Because they were in doubt as to what was causing the difficulty in Grenada Industries. And I think that it must have been in May of that year that—it is hard for me to say exactly who initiated the suggestion.

Q. Did somebody suggest that to you?

A. Yes. It is hard for me to say as to exactly who initiated the suggestion, but I know that Mr. L. L. Goodman, Mr. J. A. Goodman, Mr. H. V. Kobin, Mr. C. E. Stevens, Mr. J. E. Perry, and Mr. Morrow were satisfied at that time for me to be General Manager of that company. Now, if you ask me who first said what, I am not in a position to say.

Q. Now, you testified previously about your power as an officer after you went with Industries to execute contracts. Do you know whether or not the Board of Directors formally authorized you to execute contracts? Do you know of your own knowledge?

A. Yes, I do; and I think they did.

Q. Do you know about when you became President of Industries?

A. It was in 1940.

Q. About what month?

A. I don't remember.

Q. Now, when you became an officer of Industries, did you contact any other organizations throughout the country that did finishing and processing and merchandising work, to ascertain whether such organizations might take the grey goods of Grenada Industries?

A. No. When you say: did I contact them for the purpose of determining whether or not they might handle our volume?—no.

Q. Did you contact anybody other than J. A. and L. L. Goodman or Mr. Kobin or any organizations with which they might be associated?

A. If you are asking me for the purpose of determining whether or not they were willing to handle our volume—

Q. Yes.

A. —the answer would be "no".

Q. Now, referring to Exhibit 37, which is the document which you have testified previously you drew, do you recall with whom you actually discussed this document before it was executed? That is, on the part of the other parties signatory here, other than Grenada Industries?

A. I recall very definitely that I discussed it with L. L. Goodman and J. A. Goodman. I do not remember whether Mr. Barskin sat in on the meeting or not. And I recall the meeting, because I remember explaining why I was interested in having this agreement for the protection of Grenada Industries.

Q. Now, I direct your attention to Article VI of Exhibit 37, and more particularly to subparagraph (D) thereof.

Now, since you are familiar with this language, would you explain or defnie the provisions in paragraph (D), that is, provisions 1, 2, 3, 4? You might read those

separately and define what is meant by each one of those terms.

A. Well, now, this reads that "in the event that Industries' 'cost of sales', as heretofore described," which is the manufacturing cost of Industries, "are less than Mills' 'net sales proceeds', then a computation shall be made of the difference between the two for the purpose of determining the proportion that is

"1. Attributable to efficiency in greige manufacturing or other operations performed and/or supervised by Industries."

Now, I want to explain that.

That means, for example, that if it is strictly grey goods, then it is what Industries could command for grey goods, the grey market price. If, however, it is finished merchandise, then it would have to be the price that Industries could command for finished merchandise that had not been sold.

Q. Well, now, what do you mean by the terms "attributable to efficiency in greige manufacturing"?

A. I mean by that, for example, that if it costs us two dollars a dozen to make it and the grey market price is seven dollars, we are still entitled to the seven dollars; that the cost itself has nothing to do with the price which we are entitled to receive for the merchandise.

Q. Now, who was to fix the amounts that are set forth in subparagraph 2?

A. Mills was supposed to supervise that.

Q. When you say "Mills"; who did you have in mind was going to fix that? Messrs. L. L. and J. A. Goodman?

A. L. L. and J. A. Goodman.

Q. Were you going to have anything to say about what was arrived at in that figure?

A. Actually, of course, I had only a cursory interest in it, because indirectly it might affect us, but actually in the grey goods price whatever we were charged we passed on.

Q. So you didn't care—

A. I didn't care as long as they weren't just screwey or crazy charges, you see. As long as they were fair and reasonable charges, I was satisfied.

Q. Now, turning your attention to No. 3, were J. A. and L. L. Goodman to fix that figure? That is, the value of any merchandising plans that should be developed?

A. Yes. Yes, the figure would be very simply the amount of money that they could get additionally for the merchandise as a finished product; because, for example, they were selling it as a brand, or they were selling it in a fit service, or they had some unique system of distribution, or anything that was attributable to that. In other words, if it were grey goods, any price over the grey goods price, less the actual cost of finishing that, we incurred.

Q. And you didn't have any real interest in what the might be, then? That didn't affect you detrimentally in any way?

A. No.

May I withdraw that a moment? May I say that the only interest I would have in that would be that in connection with the silk hosiery I would want to make sure that they got the best price they could for the silk hosiery if that price was going to be lower than cost. I mean, with that exception your statement is correct.

Q. Well, now, would your testimony with respect to 2 and 3 also apply to subparagraph 4, "attributable to efficient selling"?

A. Yes.

Q. That, again, would not detrimentally affect Grenada Industries?

A. That is right, essentially.

Q. Essentially.

A. That is right.

Q. In your previous testimony, you have referred to a phrase several times, I believe, "cost of manufacture" or "cost of manufacturing". When you use that phrase, do you mean actual cost of manufacture without any profit at all added, or without the concept of fair market value? Or do you mean with a reasonable profit added to the actual cost?

A. Well, cost of manufacture, if we are speaking strictly on a cost basis, represents the cost, the direct labor and direct material cost, and indirect labor and overhead, that you incur in a business. Fair market value would represent the difference between those costs and your income.

Q. Well, and what I want to know is: When you use it in your testimony that you have previously given, you are referring to it then as just the actual cost with no profit margin added?

A. Well, of course, you are asking me to go back in context, but I would say that is the way I would normally use it, yes.

Q. I mean, that is your general use of the term?

A. That is my general use of the term.

Q. Now, do you know who was responsible for the supervision of the accounting system of Grenada Industries, Inc.?

A. Well, the general ledgers of Grenada Industries, Incorporated, were carried in Indianapolis. In Grenada, Mississippi, we carried many subledgers, payroll, raw material, expense ledgers, and so on and so forth; but the general ledgers were carried in Indianapolis for a few very potent reasons.

The first was that Grenada Industries was in Grenada, Mississippi, which was 50 miles from nowhere, and to get a really competent bookkeeper into Grenada, Mississippi, was a very difficult thing to do. Although we did later during the war, because we had to, even in that case we had a terrible housing problem solving that situation. Whenever we had the problem of getting a technician into Grenada, that was a very sizable problem.

The second reason was that the mechanics, most of the mechanics, as to the general ledger, would occur in Indianapolis, so that physically it would make for more efficiency for them to be kept there.

Q. Do you know under whose supervision the general ledger was kept at Indianapolis during this taxable period?

A. I looked to Stevens for information on Grenada.

Q. Do you know who prepared the tax returns of Grenada Industries?

A. C. E. Stevens.

Q. Were they prepared here in Indianapolis, as far as you know?

A. As far as I know.

Q. You sent to Indianapolis periodically, didn't you, the subledgers and journals and other books that you kept at Grenada for auditing purposes?

A. No, I think on the contrary, Mr. Stevens came down to Grenada and audited those. Both may have happened. But I think in general Mr. Stevens came down there and audited them.

Q. Now, with respect to your testimony as to the obtaining of nylon yarns, you have been in the Court room today, haven't you all through the day?

A. Yes.

Q. And you heard the testimony of Mr. L. L. Goodman, and you heard it with respect to that situation ob-

taining between J. A. Goodman, L. L. Goodman, and the duPont organization?

A. Yes, sir.

Q. So isn't it your understanding that the nylon yarn was obtained through that relationship between J. A. and L. L. Goodman and the duPont organization?

A. Of course, it is always hard to add up all the things that go into the obtaining of nylon yarn. I would like to believe that the efficiency of Grenada Industries had something to do with it. But to look at it cold-bloodedly, we have to recognize that here are two men that had a reputation as hosiery manufacturers probably second to none in the country, and certainly they commanded a lot of respect at the duPont organization. So I think that if he feels that he got the nylon yarn, he has reason for feeling that way.

Q. You think then that Mr. Goodman's testimony would be the best evidence on that, don't you?

A. I might argue with him a little bit, but it would be a matter of degree.

Q. Now, turning to the arrangement by which Industries merchandised its grey hosiery, did you make any suggestion that an organization, either a corporation or a partnership, be formed, back in '38 or '39, to enter into a contract with Industries for that? Did any suggestion of that kind come from you?

A. I will answer that this way. I will say that when I took the responsibility at Grenada Industries, and I think even before I became an officer in the corporation, I wanted to know just what my responsibility consisted of. And it was very apparent to me, and I am sure would have been to you had you been there, with those problems, that it was going to be all that we could do to establish a successful grey mill in a new section of the country with new and deficient equipment.

Now, as matter of fact, as events turned out, the Julius Kayser Company tried to establish a grey unit in Hattisburg, Mississippi, with very similar, even later equipment, and failed to do it successfully and removed the plant.

Q. Now, what I am directing my question to Mr. Solar, is this: Isn't it true that you were interested first in obtaining a good, fair market price for your grey hosiery manufactured at Grenada?

A. A fair grey market price and a permanent outlet.

Q. Yes. But you had no interest in what legal form that outlet took; isn't that right?

A. That is correct.

Q. In other words, you had confidence in dealing with J. A. and L. L. Goodman and their interests?

A. Yes.

Q. You didn't have any interest particularly in what form they decided to cast their business organizations into?

A. No.

Q. You didn't advise them to cast them in any certain form, did you?

A. No.

Q. Did you know during this taxable period that hosiery manufactured at Grenada was being sold by salesmen employed by the National Hosiery Mills?

A. Oh, yes.

Q. You knew that?

A. Oh, yes.

Q. You knew that no partnership had any salesmen of its own, didn't you?

A. Yes, but I didn't think it—

Q. Just answer my question. You knew that no other organization except National was actually merchandising your goods?

A. Yes, I knew that.

Q. You knew that the organization designated Grenada Hosiery Mills had no machines at all, didn't you?

A. Yes, I knew that.

Q. You knew they had no finishing facilities at all?

A. Yes, I knew that.

Q. And you knew that all finishing and processing facilities were dependent on the National facilities?

A. No. You see, there you fall into the same—forgive me if I use the word—error in your use of the word "finishing". The actual finishing, the mechanical process of finishing, is of very small consequence in the problem of knowing what and how to finish. Now, what I had as protection for Grenada Industries was the know-how of L. L. Goodman and J. A. Goodman on how to get merchandise finished. They could walk into the Hans Bick Company or the Lee Dye Works, or any other organization, and tell them exactly what they wanted to do; or, for that matter, set up an independent finishing organization of their own. Because they knew how. And that was the protection that I had.

Q. Now, in your dealings with, first, Grenada Knitting Mills, and then later with the organization known as Grenada Hosiery Mills, with whom did you deal? With what people?

A. I dealt largely with L. L. Goodman and J. A. Goodman.

Q. Did you ever deal with the Security Bank and Trust Company of Indianapolis?

A. No.

Q. Did you ever deal with any of the children of J. A. or L. L. Goodman?

A. No.

Q. Did you ever deal with C. E. Stevens?

A. Yes. I might say that I did. As far as C. E. Stevens is conerned, I dealt with him. I knew for example that C. E. Stevens controlled the ownership of Grenada Hosiery Mills. I mean, that was a matter that I knew.

Q. Did you ever deal with C. E. Stevens in connection with merchandising or styling of hosiery?

A. No. No, that wasn't his experience. I think that my dealings with C. E. Stevens were that I had to be satisfied that C. E. Stevens was satisfied with anything that went on.

But I think that C. E. Stevens had confidence in L. L. Goodman and J. A. Goodman.

So my direct dealings, from a practical point of view, were with L. L. Goodman and J. A. Goodman.

Q. You didn't have any responsibility for the keeping of the books and records of Grenada Industries, did you?

A. Well, I felt a certain responsibility when I became president of the company. I mean, I felt that it was my job to know what was going on. And I did know.

Q. Did you ever examine into the books and records?

A. Well, I am not an accountant, but I got reports, I would say, certainly at least once every thirty days, of what the situation was. And, you know, with certain key figures, you can know pretty much what is going on.

Q. Well, who prepared those reports?

A. I think they were prepared under the supervision of Mr. Stevens.

Q. Do you know whether or not there was any written agreement between an organization known as the Sulaine Company and Grenada Industries, Inc. for the use of certain machines?

A. I am definitely of the opinion that there was a rental agreement between the two.

Q. In writing?

A. I think there was.

Mr. Ponder:
I believe that is all, your Honor.

Mr. Littleton:
That is all.

(Witness excused.)

Mr. Littleton:
We can start another witness, or we can take a recess until the morning.

The Court:
I think you can start.

Mr. Littleton:
Mr. Barskin?

Whereupon A. J. BARSKIN was called as a witness and, having been first duly sworn, was examined and testified as follows:

The Clerk:
Have a seat, sir, and state your name and address.

The Witness:
A. J. Barskin, Abraham J. Barskin, 5640 North Penn.

Direct Examination.

By Mr. Littleton:
Q. Mr. Barskin, how old are you, sir?
A. I was sixty in June, June 22.

Q. Where do you reside?

A. In Indianapolis.

Q. What business are you engaged in? What industry or business?

A. Right now I am working with the National Hosiery Mill. I have been working with them a long time.

Q. Will you speak a little louder, please, Mr. Barskin?

A. All right. I will speak a little louder.

Q. You say you are connected with the National Hosiery Mills?

A. That is right.

Q. And what other organization?

A. Well, Abar Processing Company.

Q. Is that a corporation at this time?

A. Yes, I think it is.

Q. What experience had you had in the hosiery industry prior to the time you became associated with National Hosiery?

A. Well, my experience in the hosiery business was that I lived in Philadelphia until 1913, and I used to be around the hosiery mills in different places.

Q. What was your experience in the hosiery industry or anything allied with the hosiery industry while you lived at Philadelphia?

A. Well, I used to be around what they called the converters. They would buy seconds off the machines, grey or finished, thirds, menders, press-offs, and they would fix them and sell them to the trade.

Q. Did you at anytime get into that business on your own account?

A. No.

Q. While you were in Philadelphia?

A. No, sir.

Q. What work were you engaged in while you were in Philadelphia? What livelihood?

A. Well, I was over there working in different stores and working around selling some of these goods from these converters. I was selling them.

Q. Were you selling to stores?

A. To jobbers, to stores, to everybody that could use the cheap merchandise like that.

Q. You were disposing of the merchandise of these coverters, you say?

A. That is right.

Q. And in that you were the salesman, the solicitor?

A. Yes.

Q. Whom did you sell to?

A. There was a fellow by the name of Grant that used to buy a lot of that stuff there, and there was Siegel and Company of New York that used to buy a lot of it. From different converters, they used to buy the hosiery and sell it to pushcarts and to basement stores. They were all jobbers.

Q. You recommended the converter?

A. That is right.

Q. And acted as his salesman to find a market for his converted hosiery?

A. That is right.

Q. When you came to Indianapolis, with what organization did you become associated?

A. Well, when I came to Indianapolis, I opened up a retail store here.

Q. A retail store?

A. That is right.

Q. In what line of merchandise?

A. Oh, just like cheap department stores in the neighborhood streets, like Virginia Avenue.

Q. How long were you in the mercantile business in that capacity?

A. Oh, from 1914 to 1925.

Q. At that time, did you discontinue your mercantile store?

A. Yes, sir.

Q. What business did you then associate yourself with?

A. I went into Realsilk.

Q. What was your business at Realsilk?

A. When I went into Realsilk, the first time I went in was when I made arrangements with them to buy their returns, their throw-outs, just like I did in the east.

Q. That was an independent business?

A. An independent business.

Q. And how long did you continue in that?

A. Well, the first year I was for myself. I bought for myself. Then Realsilk took it over, and I worked for them from 1925 until 1928.

Q. That is, you became their salvager?

A. Their Salvager. That is right.

Q. And did you have a department of that nature in Realsilk?

A. That is right. I called it the Keystone.

Q. How was your compensation paid?

A. Well, they paid me.

Q. Did you draw a salary or a commission?

A. A salary, for running that part of the business.

Q. Was that a substantial volume of business?

A. Well, at that time it was.

Q. Did you deal with reference to salvage there with anyone besides Realsilk?

A. Not at that time.

Q. What was the nature of the salvage that you handled there? What did you do to it?

A. A lot of these returns that came back had to be mended, and had been sewed up, there, on different machines, and they had to be stripped and dyed again

and put into different colors an then sold. For instance, they might be black today, and tomorrow they would be brown.

Q. Where was the market for that class of goods?

A. At that time heavy silk had a pretty good market. Of course, silk was high at that time.

Q. How long were you with Realsilk?

A. Up until 1928.

Q. Then what happened to you?

A. Then, when Mr. H. V. Kobin went and opened up National, I went with him.

Q. What were your duties over at National at that time?

A. I helped him run the manufacturing end of it.

Q. The production?

A. The production and manufacturing.

Q. How long were you with Mr. Kobin in National Hosiery?

A. Oh, I am still there with him.

Q. What position do you hold there now?

A. Well, now, I am Secretary, and I am doing purchasing. I am purchasing agent over there for all different chemicals, needles, everything they need.

Q. You are the purchasing man in charge of the procurement?

A. That is right.

Q. Of all the procurement?

A. Yes.

Q. Does the procurement of yarn come under your jurisdiction?

A. Not of yarn, everything else but the yarn.

Q. Everything else but the yarn?

A. Yes.

Q. All the equipment, supplies, and everything?

A. Supplies and everything else, packing supplies or anything else needed.

Q. Did you at any time become interested in the operation of a processing organization?

A. Yes, sir.

Q. What was that organization?

A. Abar Processing Company.

Q. When was that started?

A. In 1942, if I remember right.

Q. Was anyone else interested in that with you?

A. Yes.

Q. Who?

A. Why, it was a partnership at that time, I think. I am not sure, but I think it was a partnership at that time.

Q. What was the nature of the business of the Abar Process Company?

A. Well, I went back again to my own business.

Q. Pardon?

A. You see, the time came for nylon yarn. At that time nylon yarn was scarce, and also nylon stockings were scarce, and that is when I went back to the business and tried to salvage all the nylon yarn that I could from the press-offs, and also the nylon stockings from the grey or the finished, when they threw it out as waste; I would take them and finish them, redye them, and sell them, like I used to do years ago.

Q. Did you have anything to do with the designing of a machine to carry on that work?

A. I did, sir. You see, when they started to make the nylon stockings, they made what they called a three-carrier stocking. Silk, you know, used to be made with just the one carrier. So there had to be something designed tc take each thread off separate. So I designed a machine that we called the back-winding machine. Not

a coner; a coner is just one that cones it. I took each thread off in a different cone, just exactly like they would come on, on the stockings.

Q. And your machine would take it off and recone it?

A. Each would be separate, the different cones. I would have three cones, the same way that they would go on the stockings.

Q. From what source would you get your material, or your waste material, from which you would reclaim the yarn?

A. Well, at that time, when materials got scarce, I went to Philadelphia, and I bought materials from everywhere I could buy, from factories that didn't know what to do with them.

Q. Did you buy any from Fulton Hosiery?

A. I did.

Q. From Industries?

A. From National, from Industries; but it wasn't enough. I thought that I could use more, so I bought from other people.

Q. Well, did you have a price which you paid for that?

A. Yes, it was 50 cents a pound for the price.

Q. Was it an established price?

A. The established price.

Q. Did you pay that to Industries?

A. Yes, they got their price.

Q. Did you pay it to National?

A. To National, to Industries, and to Fulton.

Q. Prior to the time that you organized Abar Process, do you know what disposition National made of its waste material?

A. Sold it as waste, just like any other hosiery people do, even today.

Q. In connection with your salvaging of the yarn from imperfect hosiery, did you also do any work on injured hosiery, or hosiery that was incomplete or irregular?

A. Yes.

Q. From what source did you get that material?

A. Well, that is what we call a press-off. Maybe a stocking will be made on a machine, and something was wrong with the toe. They call that a press-off, and it sells as waste.

Q. It sells as waste?

A. And I would take it and fix it on another machine.

Q. Would you get that in the waste that you got from these various machines?

A. That is right.

Q. You would have it priced, and what you thought could be repaired—

A. We did. We repaired it and sold it under a different name, the K Specials, so that they wouldn't be sold the same way as the other hosiery.

Q. Would that be finished hosiery, or grey hosiery, at the time you reclaimed it?

A. Finished hosiery.

Q. It would be finished hosiery at the time you reclaimed it?

A. That is right. I would have it in the reclaimed. It would be grey and finished, but I would sell them for finished hosiery and have them dyed.

Q. But when you found it on the market in your waste, what was its status?

A. In the grey.

Q. What arrangements would be made for finishing that hosiery?

A. Well, I paid for finishing. We had arrangements made with National to finish those for us at the regular price that they would charge anybody else.

Q. Is that a customary practice in the hosiery industry to finish hosiery for mills?

A. For mills, for grey mills.

Q. And is the price for those services generally fixed in the industry?

A. That is right, generally fixed in the industry.

Q. After this mended hosiery was finished and classified as K Specials, how was it disposed of to the trade?

A. It was sold in New York to jobbers.

Q. Sold in New York to jobbers; and it was shipped to those jobbers?

A. It was shipped to those jobbers, and they would sell it to the retailers.

Q. They would sell it to the retail trade?

A. Yes.

Q. What disposition did you make of your reclaimed yarn?

A. After I would get it back again on cones of yarn, I would sell the yarn back again.

Q. Now, at what price would you sell that yarn?

A. A pretty fair profit price, whatever the market was. I can't remember right now.

Q. What would determine the price at which it was sold? Was there a standard price?

A. There was a standard price.

Q. Would that bring the same price—

A. As they paid anybody else.

Q. —as original yarn, or manufactured yarn?

A. That is right.

Q. What is your outlet for that type of material?

A. Oh, plenty, if I had had enough. But I couldn't get it.

Q. Well, what was your outlet, Mr. Barskin? Where did you sell it? You sold it, didn't you?

A. Yes. I sold some of them to Fulton, some to National, some to Industries, and some of them I sold in Philadelphia, that they couldn't use.

Q. Sold it in Philadelphia. Did they pay you for it?

A. That is right. They were billed, and they paid us for it.

Q. It was billed to them, and they paid you?

A. In the regular way.

Q. Did you receive the same price for that which you sold to National that you received when sold to your Philadelphia concern?

A. Same price; that is right.

Q. And from Fulton?

A. Same price from Fulton.

Q. Industries?

A. Same price.

Q. To what organization would you say you sold the majority of your reclaimed yarn?

A. Well, I couldn't tell you offhand. I sold some—Mostly what I sold would be to either Fulton, National, or Industries.

Q. Well, as between Industries, National, and Fulton, which of those organizations would you sell a larger proporation, if you did?

A. Well, Industries used more yarn than the others, because they had a bigger production.

Q. Is Abar still operated as a partnership?

A. At that time.

Q. Is it operated as a partnership at this time, at this particular day?

A. I don't know, sir. I don't think so. I think it is a corporation now.

Q. Do you have stock in the corporation?

A. Yes, sir.

Q. Where is it operated? At what place?

A. At Martinsville now, Martinsville, Indiana.
Q. Who is in charge of its operation?
A. I am, sir.

Mr. Littleton:
You can cross-examine.

Mr. Ponder:
I think I can dispose of my cross-examination in a few minutes, your Honor, and then that would possibly release this witness, if that is all right.

The Court:
All right, proceed.

Mr. Ponder:
I believe I can do that within five minutes or so.

Cross Examination.

By Mr. Ponder:
Q. Mr. Barskin, are you related by blood or marriage to either J. A. or L. L. Goodman?
A. Yes, I was, up until 1940. My wife died. I married her sister. She died in 1940.
Q. Do you know, Mr. Barskin, who were the partners of record of the Abar Processing Company in 1942?
A. Yes, I believe it was L. L. Goodman, J. A. Goodman, H. V. Kobin, and myself at that time.
Q. Did they continue in that situation, or that relationship, throughout the years '42 and '43?
A. That is right, until Solar came in, of course. He has got part of it now, too.
Q. Now, isn't it true that the machines that were utilized by the Abar Processing Company were old ma-

chines that had formerly been used by National and by Fulton?

A. That was coning machines, to cone off the yarn, you see. They used to use it to cone up small cones of yarn and make bigger ones so they could use them. We used these old machines, but we had to have the other machine for back-winding them.

Q. Do you know whether or not there was any amount paid to National and Fulton to purchase those machines that had been used for that reconing?

A. At that time, if we did purchase, we sold it back to them, but I don't remember anything of that.

Q. In your testimony you have been saying that "I" did this and "I" did that. Do you mean to say that you managed the operations of the Abar Process Company?

A. That is right.

Q. Were you in charge of those operations?

A. That is right, sir.

Q. Did any of the record partners of Abar Process Company in 1942 and '43 take any part in managing or directing the operations?

A. Not in managing it. Not in running that. But we are always together in directing the management. We all talk it over, as far as that is concerned, just as it is in any company. But I was the one, when we moved over to Martinsville in '42; I was running it then, and I am still running it today.

Q. You are in active charge?

A. That is right, active charge.

Mr. Ponder:

I don't have any other questions.

Mr. Littleton:
That is all.

(Witness excused.)

The Court:
We will reconvene tomorrow morning at 10 o'clock.

(Whereupon, at 5:03 o'clock p. m., Wednesday, November 1, 1950, the hearing in the above-entitled matter was adjourned, to reconvene Thursday, November 2, 1950, at 10:00 o'clock a. m.)

OFFICIAL REPORT OF PROCEEDINGS.

Filed Nov. 15, 1950.

Before The Tax Court of the United States.

Docket No. 24571, 24640.

Greneda Industries, National Hosiery Mills, Inc.,
Petitioner,
vs.
Commissioner of Internal Revenue, Respondent.

Hearing at Indianapolis, Indiana.

Date November 2, 1950.

The Tax Court of the United States.

Grenada Industries, Inc., Petitioner,
vs. Docket No. 24571.
Commissioner of Internal Revenue, Respondent.

National Hosiery Mills, Inc., Petitioner,
vs. Docket No. 24640.
Commissioner of Internal Revenue, Respondent.

Room 216,
U. S. Post Office,
Indianapolis, Indiana,
Thursday, November 2, 1950.

Met, pursuant to adjournment, at 10:00 o'clock a. m.

Before: Hon. Arnold Raum, Judge.

Appearances:
(As heretofore noted.)

The Court:

Before we proceed with the trial in the pending case, I would like to outline to counsel certain that I have had thus far in the case, so that if the trial progresses you might bear them in mind and try to clear them up for me.

As I understand both the deficiency notice and the theory of the Government's case as outlined by Mr. Ponder at the beginning of the trial, it has a two-fold basis.

First, it is based upon Section 45, and secondly upon, shall we say, an effort to disregard the organizational existence of Hosiery and Abar.

I think I can understand quite clearly both the Government's theory and the Petitioner's response to it with respect to the second branch of the case. As I understand the Government's theory on the second branch of the case, it is that—well, take Hosiery, for example—that there was really only one series of transactions, in which the component parts added up to one major operation, comprehending both the activities of Industries and Hosiery, all under the guiding genius of the two Goodmans, and that Hosiery was nothing but a paper organization that should be disregarded for tax purposes.

Petitioner in turn contests that and argues that Hosiery was a duly organized partnership, that it had a recognized function comparable to that which might have been performed by any outside organization, and it indeed points to an inconsistency in the Commissioner's position in that the Commissioner himself recognizes Hosiery for certain purposes in allocating a percentage of income to the partners.

I haven't attempted here to make a complete outline of the positions of both parties, but I have indicated sufficient, I think, to show that I am following the trend of the arguments made by both of them and I can see the relevance of all the evidence that has been introduced thus far in relation to this issue.

Now, my difficulties relate not to this issue, but they relate to the Section 45 issue. Section 45 presupposes, as I understand it, the separate existence of different organizations, but authorizes the Commissioner in certain circumstances to reallocate income of one organization to that of another, on the theory that the income that is being reallocated is really the income that has been earned by the organization to which it is allocated rather than by the one to which it has been nominally ascribed by the parties.

It is in relation to this second issue that I have difficulty in focusing the evidence. There has been very little fi any attempt to break down the value of the services, so-called, that were rendered by Hosiery, and I am not clear as to just what the Government's position is in this connection.

Let me make my question more concrete: Is it the Government's position that Industries was really selling a finished product, and not merely hosiery in the grey, and that Industries had made arrangements with National to do the various finishing operations on Industries' behalf, and that Hosiery, in undertaking to merchandise and sell the finished product, was acting on Industries' behalf and was really ascribing to itself the much larger portion of the profit on the entire transaction than its services would warrant? Now, if that is the Government's position, then I think it would be important to know just what the services of Hosiery were worth, so that we would have some idea of being able to make a breakdown be-

tween what the services of Hosiery were, on the one hand, and that portion of the profit now allocated to Hosiery but which the Commissioner wishes to allocate to Industries.

Do I make myself clear?

Mr. Littleton:

You do, your Honor. Very clear. I think you have as clear a picture of the case as could be gathered by anyone.

The Court:

The thrust of my difficulties, I fear, is aimed probably more at the Government than at the petitioner, since it is the Government that is unertaking to make an allocation. But in the last analysis, this Court must decide whether a Section 45 allocation is appropriate in the circumstances of this case, and I am groping around trying to find material, or, if I may change the figure of speech, I am groping around trying to find something to anchor to, in relation to the Section 45 question.

I don't care whether counsel desires to make a short statement now to try to tie things together that have gone on thus far, or would prefer to let the trial develop and see how things turn out. But I just did want you to know what my difficulties are at this point, so that you may have them in mind as the trial progresses, and also have them in mind when you come to prepare your briefs.

Mr. Ponder:

I would just like to mention one thing in that connection, your Honor.

In the Revenue Agent's Report, which is in evidence as an exhibit, there is a computation showing the formula

or method that was used by the Commissioner in making the allocation to Grenada Industries and to National; and the method in brief was, of course, that a figure was used of $6.66 a dozen pair of hose, cost of producing that dozen. Then, by the Commissioner's determination, he has found $5.85 to have been Industries' cost in putting the finishing product on the market, and the balance of the $6.66 being National's. He has made the allocation then of Hosiery's income, after the minor deductions we have mentioned previously, one to the $5.85 of $6.66 to Industries, and the balance to National. I just mention that as the formula which has been used.

And it is the Government's decision that, that determination having been made on the basis that that is the best the Commissioner has been able to determine on the basis of the books and records of the two companies, the burden then of showing that allocation—First, as I see it, we have to get to the problem under 45 of: has the Commissioner erred or abused his authority in making an allocation? Then, if the Court should find that the Commissioner has not erred in that regard, when we approach the question of how it should be allocated, then, as I say, it is the Government's position that the determination is presumptively correct unless other evidence is introduced to show that some other formula should be used if allocation is proper. I just thought I would mention that to you to explain the Government's position on that point.

The Court:

Is it agreed between the parties that the hosiery at all times, that was being sold, even after it had been finished by National, was the hosiery of Industries? In other words, did Hosiery act merely as an agent for the sale of Industries' hosiery and render such other functions as have been described by the witnesses, namely, styling

and other general functions that might come under the head, say, of merchandising functions? But apart from that, are the parties in agreement that the hosiery that is being sold ultimately, the finished hosiery, was the hosiery of Industries?

Mr. Littleton:

I think the hosiery belonged to Industries, and it was bailed to National for finishing on a bailment arrangement.

The Court:

The hosiery was not sold by Industries to Hosiery?

Mr. Littleton:

No, it was not sold. Hosiery was an independent contractor, we will say, and Industries employed its services to get its merchandising program and to supervise the selling of its merchandise.

The Court:

That is my understanding. I just wanted to make sure that the parties were in agreement upon that.

Mr. Ponder:

That is the Government's understanding and position, that there was no passage of title for the hosiery from Industries to Hosiery and then from Hosiery to the ultimate purchaser, but that at all times the hosiery remained the property of Industries.

The Court:

I won't delay the progress of the trial any further. I just thought that it might be helpful to both of you to know what difficulties I have had thus far.

Mr. Littleton:

Hosiery was not an agent. It was an independent contractor rendering the services, and Industries could have employed those services from New York or Chicago or some other place, but we felt we could render them here with the same benefit and efficiency.

Now, if Your Honor please, on the question of 45, if I may, I don't want to appear presumptive, but Section 45 was taken out of the Revenue Acts of 1918 and 1920 and 1924 and 1926, and when we came to the '28 Act, we separated the privilege of taxpayers and related businesses closely owned by the same interests of filing consolidated returns. In consolidated returns under those previous Acts, the return could be filed in the name of the parent company. The parent company may be merely a holding company. It would have four or five other subsidiary corporations being the business organizations. All the income would be lumped in there. All the expenses would be lumped. And all the invested capital would be lumped. That went on for such a period of years that business had adopted the practice of keeping a consolidated account of all of its operations. So that when the separation came on, and they began to file separate returns, accounting for their separate income, gross income and separate expenses and separate deductions, and so forth and so on, we found those consolidated accounts on their records, and it was difficult sometimes to say what expenses belonged to this organization and what expenses belonged to that and what the income of this was. And then there was also the further proposition that they could have one corporation operating in one phase of the industry sustaining large losses, and another operating having large gross in-

come; so that there could be a milking of the net income into this losing corporation, and the owners, being the same, would ultimately have the fruits of the operations.

Section 45, when the consolidation was repealed in the '28 Act, was lifted out of that and put in as an independent section, so that the Commissioner would have authority to go in and break down those accounts if he found them all lumped together. And for a long time, the taxpayer had a right to demand that that be done if it was to its interest.

But finally, when that was all cleared out, about the 1934 Act or the 1932 Act, that was put back in there as a discretionary power of the Commissioner. And when he undertakes to do that, he has a high degree of discretion. He is supposed to function rightly and properly, but if he acts arbitrarily and capriciously, what he tries to allocate becomes no allocation at all.

And if we establish that he has acted erroneously in that respect, that just ends the proposition, and we have met the burden. We don't have to show that there was allocation or what the allocation should be if allocation were proper.

We say in this case that he has no right to allocate net income. That is not comprehended in Section 45, but that is what he has undertaken to do. And it isn't a question of the reasonableness of this compensation. It is a question of whether or not the expenses and the income, and so forth and so on, were distributed between two independent organizations improperly

so that the losses of one would fall into the pockets of another.

In this case, all of the organizations were making profits. There was no milking proposition. And there could be no evasion of taxes in that respect.

So I think Your Honor has comprehended from the testimony a very vivid and clear picture of what is involved in this case.

The Court:

Of course, the Government's position is, I presume, that Industries was not really selling hosiery in the grey; that it was selling a finished product; and therefore that it is not fair to measure Industries' profit by what it would have obtained had it simply been selling hosiery in the grey. But that, in turn, it would seem to me, should call for some kind of inquiry into the value of the services that were rendered by Hosiery. And thus far I have not heard, unless it has eluded me, any testimony as to the value of the services rendered by Hosiery.

Mr. Littleton:

Your Honor, we have checked the preferred stock holdings of Industries and National, covering the period through December 31, 1937 for National, which will be Petitioner's 38.

Mr. Ponder:

That can be a Joint Exhibit.

The Clerk:

Marked for identification; Exhibit 38-Q.

(Joint Exhibit 38Q was marked for identification.)

The Court:
Admitted.

(Joint Exhibit 38Q was received in evidence.)

Mr. Littleton:
I offer a list of the preferred stock of Grenada Industries, Inc., from December 31, 1938 down to December 31, 1944, as Joint Exhibit 39 R.

The Court:
Admitted.

The Clerk:
Joint Exhibit 39 R; admitted in evidence.

(Joint Exhibit 39 R was received in evidence.)

The Court:
May I interrupt and cut back to the general inquiries that I was making at the outset?

We have before the Court two taxpayers and not one. That is, we have Grenada Industries, and we have National, before us.

Mr. Littleton:
Yes, Your Honor.

The Court:
And the testimony thus far, to the extent that it has related to these issues, has focused upon Grenada Industries rather than upon National. And I presume that counsel before the trial is over will in some way

undertake to deal with the issues as they affect National as well.

Mr. Littleton:

I think the National case was consolidated, and if we were trying them separately, that would be one thing; but the testimony has come in without distinction as to which case it is being offered in. It is consolidated testimony. And in so far as it relates to the tax liability of National on these issues, the allocation is made upon the basis that the finishing services of the goods of Industries were performed by National under the bail agreement, and the testimony is that it has made its usual and reasonable charges for those services, including the actual cost plus gross profit on its costs, overhead, and so forth. And that would be gross income to it. We say that those charges were not too high or to low, that they were reasonable, and what we would pay if we had employed those services from an absolute stranger and dealt at arm's length. That is the only fact evidence that could be offered with reference to the liability of National. And it is true with Abar. Abar dealt with National. It dealt with Industries, in acquiring waste, paying 50 cents a pound for the waste, reclaming it, coning it into usable yarn, and selling that yarn to them, probably favoring them with reference to the supply, but charging them the same price that they would charge any outsider.

The Court:

Does that agree with the Government's concept of the case? I don't mean does it agree with your view of it, but—

Mr. Ponder:

You mean as to the evidence that has gone in, the impact? Yes, I would say when the evidence is developed with respect to Industries, under the allocation employed by the Commissioner 585/666 was included in Industries tires' income, and only the very small remaining portion was included in the income of National. So I think that is probably why the evidence has largely preponderated developing the Industries phase of the relationship. But I will say this: that I believe that the evidence that will be developed this morning will throw further light on the charges between the corporations, or between partnerships and corporations, and the method arrived at, which will, I believe, bring out the Government's position that these charges were aboslutely illusory or were not definitely susceptible of being nailed down at any one time, but were under the formulas put in in the agreements, whether through premeditation or not, fluctuating as the parties desired them to fluctuate.

The Court:

I will delay you no longer. You may proceed.

Mr. Littleton:

If Your Honor please, at this time I want to offer in evidence as Petitioner's Exhibit 40 the supplemental agent's report on Grenada Industries, Inc. for the fiscal years through March 31, '43, and March 31, '44, which ties in the original report with the deficiency notice. There were certain adjustments made, based upon the allowance of amortization for emergency facilities that it used.

Mr. Ponder:

The Respondent has no objection to its reception for the purpose stated by counsel for Petitioner.

The Court:

Admitted.

The Clerk:

Admitted in evidence; Petitioner's Exhibit 40.

(Petitioner's Exhibit No. 40 was received in evidence.)

Mr. Littleton:

If the Court please, our position is that the returns filed reflected the gross and net income of these two taxpayers and the deductions that were claimed by them in arriving at net income. Those returns have been audited, and in connection with the audit, and examination of those returns our books and records have been audited. The results of the audits of our books and records and the examinations of our returns are reflected in the Revenue Agent's Report, which is the customary procedure adopted and prescribed by law to reconcile any discrepancies that may appear in our returns when our books are examined. No discrepancies have been reported from an administrative standpoint. We accept the agent's report under our protests, with the exception of the adjustments that he proposes with reference to the allocation of the net income of Hosiery, part to National and part to Industries, of Abar, part to Industries and part to National and part to Fulton. Now, that is the controversial issue, and we don't believe it is the function of the Court to go behind the returns or the

examinations made by the Commissioner or go behind his deficiency notice.

So now, Your Honor, we feel that our record on the issues presented has been made clear, and we see no necessity of going any further in trying to justfy our returns, because we have the agent's report on them. But if the Commissioner's office at this time, or the General Counsel, is desirous of raising any new issues or going behind the Revenue Agent's Report, the books and records of all these businesses in the original form are available for any examination that he might want to make to them. We don't want to burden the Court with detailing them, and we think we would be doing the wrong thing if we did. So we close the case at this time.

Mr. Ponder:

That being the situation, I would like to call Mr. Stevens as a witness for the Respondent, inasmuch as I have several questions that I want to go into with respect to the accounting procedure and technique employed by the corporation.

Then I also want to recall Mr. L. L. Goodman, as I stated yesterday, after Mr. Stevens is finished, to clear up certain matters that have not yet been taken care of.

Perhaps it would be a more orderly procedure to call Mr. Goodman first.

However, maybe we should now call Mr. Stevens, and after he is finished we will know where we stand.

Whereupon CHARLES E. STEVENS was called as a witness and, having been first duly sworn, was examined and testified as follows:

The Clerk:

Have a seat, sir, and state your name and address.

The Witness:

Charles E. Stevens, 7980 Sycamore Road, Indianapolis, Indiana.

Direct Examination.

By Mr. Ponder:

Q. Mr. Stevens, what occupation are you engaged in?

A. Accountancy.

Q. How long have you been engaged in that occupation, approximately?

A. About thirty-five years.

Q. What form has your practice of that profession taken? That is, have you had a business under your own name at any time, or have you always been an employee of an organization or a company? In other words, could you describe briefly what your experience has been in the accounting field?

A. Yes. After I got out of college, I did work, special fork, for the meat packers in Chicago, of an accounting nature.

Q. Were you employed by a company, or an organization?

A. By Armour and Morrison Company. Then when that assignment was over, I sought employment with Arthur Young and Company, International Certified Public Accountants. After that I went in business in

a partnership in Chicago, certified public accountants. Then I came down here and went in business for myself.

Q. About what year was that?

A. 1926.

Q. Under your own name?

A. Under my own name, yes. I was in partnership.

Q. Yes.

A. And then, at the time we used to audit many accounts, among which was the Realsilk Hosiery Mills. I was afterwards induced to go in there and do cost work and furnish general accounting service.

Q. Now, about what year was that, that you started with Realsilk?

A. That was about 1928.

Q. Now, at that time, did you become an employee of Realsilk, or were you retained simply as an independent accountant?

A. No, I was at that time, in 1928, on their payroll.

Q. Then how long did you stay on the Realsilk payroll?

A. Until about 1932.

Q. And then what happened at that time?

A. Then I went in partnership for myself.

Q. And you left the employ of Realsilk?

A. That is right.

Q. Then how long did you remain in partnership as an independent accountant at that time?

A. I would say up to about 1944 or thereabouts. Then, after that, I continued operating under my own name and style.

Q. Now, were you employed by National Hosiery Mills at any time after the formation of that company to do accounting work for that organization?

A. No, I was engaged as a professional accountant.

Q. Do you recall about when that was?

A. I would say about 1933.

Q. About '33?

A. Yes, about that time. Around in there.

Q. How long did you do work, then, for National as an independent accountant?

A. Well, I have continued from that time to the current date.

Q. Now, did you enter the employ of National or of Industries, Inc., after 1933 or '34?

A. No, I did not.

Q. You are not on the payroll of either one of those companies now?

A. No.

Q. Isn't it a fact, Mr. Stevens, that you spend a great deal of your time at the plants of National and Fulton and American Hosiery and the other related companies?

A. I did more in the early days; that is, say, 1933, starting there, and up until probably 1940 or '41, in through there. Maybe even a little later; maybe '43.

Q. About how much of your time would you say you were engaged in work for or on account of National and related companies?

A. I would say easily 50 per cent.

Q. How long had you known J. A. and L. L. Goodman?

A. Since the days that I used to make the audit over there for the stockholders, the banks, and others, the independent audit.

Q. About what year would that be?

A. About 1926-27, in through there.

Q. Have you ever been an officer of the National Hosiery Mills?

A. No.

Q. Have you ever been an officer of Grenada Industries, Inc.?

A. No.

Q. Now, did you prepare the Federal income and excess profits tax returns of National and Grenada Industries?

A. I did.

Q. Did you also prepare the returns of Grenada Hosiery Mills?

A. I did.

Q. Grenada Knitting Mills?

A. I did.

Q. Did you also prepare the individual income tax returns of J. A. and L. L. Goodman during this period?

A. I did.

Q. Did you prepare the fiduciary income tax returns of the various trusts that have been referred to in this trial, and a chart of which is in evidence?

A. I did.

Q. You prepared all those?

A. I did.

Q. Now, are you a member of the bar?

A. I am.

Q. Have you specialized in tax matters during your practice of accounting and law?

A. In the main, yes, and also estate matters, estate tax.

Q. Have you advised Messrs. L. L. and J. A. Goodman and Mr. H. V. Kobin with reference to the arrangements of their business affairs so as to produce the minimum taxes?

A. I did.

Q. Did you advise them in that connection to create certain trusts?

A. I did.

Q. Did you furnish advice with respect to the formation of a partnership in 1940 and the cessation of active business by Grenada Knitting Mills?

A. I did. All that advice, let me say, was given keeping in mind that never did I transcend the limits of the law.

Q. In other words, as your best judgment dictated, you gave advice to minimize the taxes?

A. Yes.

Q. Now, during the taxable period, which I will describe as from 1940 to 1944, did you have supervision and control over the accounting system and records of National?

A. Yes.

Q. Did you also have supervision and control over the accounting records of all of these related companies and firms which have been refered to in this testimony?

A. I did.

Q. Is it general practice for an accountant to practice independently and also keep close supervision and control over a company's books?

A. Yes, I think that is a perfectly orderly arrangement.

Q. Now, Mr. Stevens, since the books were kept under your control, I will ask you to find the journal entry showing the record on the books of Grenada Hosiery Mills at the time of its creation in 1940, reflecting the capital account or capital investment account initially shown on the journal, and ask you if you can find that in the books and then return to

the appropriate page and read that record to the Court.

A. All right. This entry was made July 1, 1940 on the journal of the Grenada Hosiery Mills. Debit, notes receivable, $4,286.25. Investment account—that is the partnership investment account—$4,286.25 credit. Original investment—this is the explanation—original investment in Grenada Hosiery Mills as follows. And this is detail:

A. J. Barskin, $428.87.

Jacqueline Goodman Trust, $1500 even.

E. R. Goodman Trust, $1500.

Q. Does that show which E. R. Goodman Trust that was? Does it have a number by it?

A. No, it doesn't have a number, but it is the No. 2 trust. I can insert that, if it is all right.

I said Elliot Raymond Goodman Trust, $1500. In both instances it is No. 2.

Florence S. Kobin, $285.80.

H. V. Kobin, Trustee, Anne Kobin Trust, $285.79.

H. V. Kobin Trustee, William Kobin Trust, $285.79.

Those figures total $4,286.25 per the aforementioned entries of debit and credit.

Q. That is a total?

A. That is right. And that was posted to the general ledger under the investment account in the amount of $4,286.25.

Q. Now, perhaps, while I am asking you another question, this entry can be obtained in the books, to save time. I don't think I mentioned this one. The entry on or about May 17, 1941 showing the payment of the notes receivable of $4,286.25 and also at the same time showing certain withdrawals.

Now, I didn't mention that before, and perhaps that can be obtained while I ask you another question or two, to save time and speed it up.

Mr. Stevens, do you know of your own knowledge how this amount that you have given, $4,286.25, was fixed as being the amount that would be required to begin business at that time?

A. The reason I don't recall at the moment, but if I had a chance I probably could recollect it.

Q. Well, did you participate in the decision that that would be the proper amount?

A. Yes.

Q. You did?

A. Yes.

Q. And you don't recollect at all? You have no knowledge as to how that figure was fixed, and not some other—

Mr. Littleton:

I object to his cross-examining his own witness. If he asks a question and the witness answers it, that should be the end of it. He is trying to cross-examine his own witness, Your Honor, and I don't think is his privilege.

The Court:
I think he is really trying to refresh his recollection.

Mr. Littleton:
He answered the question.

Mr. Ponder:
I think from a practical standpoint the Court will redily perceive that the situation is one where counsel is examining a hostile witness.

Mr. Littleton:
No, he is not hostile, Your Honor. He knew what he was going to say when he brought him on the witness stand.

The Court:
I think I will let the question stand.

Mr. Littleton:
To that extent; but I object to his cross-examining his witness.

By Mr. Ponder:
Q. Will you answer the question, Mr. Stevens?
A. I don't recall the reason for the odd cents in this amount. But I was the one that set the figures.
Q. Do you recall how the $4200 was arrived at?
A. No, I don't, offhand. Of course, that entry was made some ten years ago, and I made a lot of entries and supervised a lot since that time.
Q. As I stated previously, I am not referring to the entry, but I ask you: Did you participate in the decision as to how that amount should be fixed?
A. Yes.

Q. You did.

A. I must have.

Q. And I am just asking you whether you have any recollection of the reasons for arriving at that amount.

A. That part I will have to answer in the negative, because I don't recall.

Q. Now, is the book entry ready, that I referred to?

Mr. Stevens, I will ask you to turn to either the journal or the ledger, and you can identify which is the appropriate record, to show if the notes receivable which you have testified to previously, in the amount of $4,286.25—whether you can find any record as to the payment of those notes, and also whether there were any withdrawals from partnership funds on or about May 17, 1941.

A. The first part of your question, referring to the book of original entry, the journal—it shows here that there was a credit to this notes receivable account that had been set up previously as a receivable of $4,286.25, and that amount was deposited in the American National Bank. And the explanation of this particular journal entry reads as follows:

"To record deposit of the following checks in payment of notes receivable May 1, 1941."

Evidently the money had been received and put in the American National Bank, as depository.

Q. Now, does that record the payment?

A. That records the payment of the note.

Q. Of the note?

A. Yes. In other words, they gave their notes at the time the investment was set up on the books.

Q. And they didn't put in cash at that time? They just put in their notes?

A. That is right, yes.

Q. And then these notes were paid on or about May 17, 1941?

A. Yes. They were paid by these individuals that I enumerated previously.

Q. Now, do you have before you the books of original entry showing any withdrawals on or about that same date?

A. Now, on May 17, which is the same day, under a later drawn journal entry, it shows a withdrawal of $25,000, the explanation being: "To record the following checks issued to partners." And these partners are identical with the partners that invested the money at the outset.

Q. And the proportions of the withdrawals: are they identical with that in the original record entry that you read previously?

A. In that proportion, yes.

Q. And the total is $25,000?

A. The total is $25,000.

I would like to say this. Did I state there that this journal entry of withdrawal, or recording of withdrawals, was dated May 17, 1941? That was a year after the original entry which recorded the investment in the business, which was dated July 1, 1940.

I would just like to add these figures up, here, for a moment.

It totals $25,000.

Q. Now, Mr. Stevens, in your capacity as an accountant doing work for National and related companies, were you familiar with the method of handling of checks that were drawn by National for work done on hosiery manufactured by Industries that passed through the records of Mills? In other words, are you familiar with the method that was used for handling of checks from National to Industries?

A. I was.

Q. Could you describe the method used, that is, the method of indorsement, when a check was made out by National, on account of work done, you see, on Industries hose? Do you know how that was indorsed then?

A. Well, again that is going back pretty far, but if I saw the check probably I could explain the way it was negotiated.

Mr. Ponder:

I will hand to the Clerk three checks which are stapled together, and I ask that they be marked for identification as a Respondent's Exhibit.

The Clerk:

Marked for identification; Exhibit S.

(Respondent's Exhibit S was marked for identification.)

By Mr. Ponder:

Q. Now, I hand you a document which has been marked Exhibit S for identification, consisting of three pieces of paper stapled together, and I ask you if you are familiar with that document and can tell what it is.

A. On the face it shows that it is a check payable to the Grenada Hosiery Mills, signed by the National Silk Hosiery Mills, Incorporated.

Q. Now, is that National Silk Hosiery Mills the same as the one now called National Hosiery Mills?

A. That is right. You see, they had to delete the name "Silk," because silk no longer was of the essence. It is dated September—the date is obliterated, here.

Q. Is that the type of check that was used to settle accounts between National, Grenada Hosiery Mills, and Industries?

A. I would say yes.

Mr. Ponder:

I might ask counsel for Petitioner if he will stipulate that those photostats are copies of the original checks taken from the records.

Mr. Littleton:

Yes, Your Honor:

Mr. Ponder:

We had agreed on that previously, but I thought the record should show.

By Mr. Ponder:

Q. Now, can you tell how those checks were indorsed or handled? That is, were they indorsed to Hosiery and then to Industries, or were they indorsed direct by National to Industries?

A. Well, as I said before, harking back ten years, it is pretty difficult to say just how these were handled.

Mr. Ponder:

I will hand the Clerk another exhibit and ask that it be marked for identification.

The Clerk.

Exhibit T, for identification.

(Respondent's Exhibit T was marked for identification.)

By Mr. Ponder:

Q. Now, Mr. Stevens, I hand you a document marked Exhibit T for identification, and ask you if you can look at that document and tell what that is.

A. That appears to be a check payable to the Grenada Hosiery Mills in the amount of $30,000 signed by the National Silk Hosiery Mills, Incorporated, A. J. Barskin, Secretary.

Q. Is that the upper portion of the document? Now, what is the lower portion?

A. The lower portion is the voucher part.

Q. That explains the reason for the payment?

A. Yes; and that lower section states as follows:

"Invoice, March 10, 1944. Amount, $30,000. Payment to Grenada Hosiery Mills, indorsed to Grenada Industries."

And that is all that is stated on there.

Mr. Ponder:

At this time, I would like to offer in evidence Exhibits S and T.

Mr. Littleton:
No objection.

The Court:
Admitted.

(Respondent's Exhibits S and T were received in evidence.)

By Mr. Ponder:

Q. Now, having refreshed your recollection of the method of handling by your reading of that language on the accompanying voucher, accompanying and attached to the check, could you now state whether or not from your knowledge that was the usual method of handling payments between these companies?

A. I would say this, that there were certain intercompany accounts, and these checks used to liquidate those accounts. So eventually all the receivables and all the payables were satisfied after the indorsement of these checks that you just presented to me.

Q. Then would you say that it was the usual method of handling?

A. Yes, in view of what it accompanied, that must have been the plan. Because we never had any difficulty with respect to keeping in reconciliation the payables and the receivables.

Mr. Ponder:

If counsel for Petitioner has no objection, I would like to have marked for identification and offered in evidence just one more of these checks, with voucher attached, so the Court will have two in case it might be better than just one.

The Clerk:
Marked for identification; Exhibit U.

(Respondent's Exhibit U was marked for identification.)

Mr. Ponder:
I offer that in evidence, then, as Respondent's Exhibit U, as being similar; in other words, two checks, with voucher attached.

The Court:
Admitted.

The Clerk:
Exhibit U.

(Respondent's Exhibit U was received in evidence.)

By Mr. Ponder:
Q. Now, Mr. Stevens, you have been in the Court room throughout this hearing, haven't you?
A. That is right.
Q. And you have heard all of the previous testimony given in the case?
A. I have.
Q. You have heard the testimony with respect to a certain agreement entered into between Industries and Gernada Hosiery Mills, on or about June 24, 1940, which is Exhibit 37 in evidence, describing and setting forth the relationship for settlement purposes at least between these parties. Now, there has been previous testimony that you were at least familiar with the method used in arriving at the amounts which would

be shown as Grenada Hosiery Mills' sales. Is that correct?

A. That is correct.

Q. You are familiar with it. Now, were you the person who actually computed the figure under this document, Exhibit 37, under the formula set forth in Articles III, IV, V, and particularly VI? Were you the person who was responsible for that computation? And if not, who was the person responsible?

A. I would just like to read this part here to refresh my recollection.

Q. Yes, I want you to read it over.

A. Yes, I recall the modus operandi.

Q. Were you the person who arrived at the figures which are set forth in the agreement, such as cost of sales, net sales proceeds, and then, coming down to Article VI, the amount which would finally be used by Industries, for example, in showing its proceeds from Hosiery? Were you the one who did that?

A. Yes, I was.

Q. Did you consult with any one else in that duty?

A. I merely followed the conditions there, in the agreement. And let me just correct that first statement. I personally did not make the entries, but they were all made under my supervision, definitely.

Q. Who arrived at the final figure, for example, which would be placed in the returns that were filed by Grenada Hosiery Mills for sales, cost of sales, other expenses, to arrive at the net shown on the returns? Were you the one who was responsible for those figures, or was somebody else?

A. I was.

Q. You were responsible. The partnership Federal income tax returns filed by the partnership?

A. I was definitely responsible for that.

Q. Now, will you explain in your own words your definition of this paragraph (D)(1), amounts attributable to efficiency in grey manufacturing or other operations performed and/or supervised by Industries? Can you explain what your definition of that phrase is?

A. Well, I would like to go back and state this: that I was the one that planned and devised all the accounting systems and in addition installed the cost accounting procedures. And in arriving at any of the figures pursuant to the terms and conditions of that agreement, I always followed the latest and correct accounting procedures and practice.

As to that specific question, as to how I assigned value to efficiency and the other things, it is very difficult to say; except that I would like to point out that I was very careful to see that each organization stood on its own feet. I knew what the costs were, and those costs were determined, of course, by people under my direction; so that when we came to a result it was perfectly evident that that was it.

Q. Well, in order to arrive at the amounts that were then placed in the income tax returns of the partnership, was it necessary for this formula set forth in this exhibit 37 that I have shown you to be interpreted?

A. Yes. That is correct.

Q. In other words, would you say that the phrase "attributable to efficiency in grey manufacturing," for example, is not complete in itself as a definition? It had to be interpreted by you?

A. That is right.

Q. Did you consult with anybody else in your interpretation?

A. I can't see that there was anybody to consult with, because I had the assignment, and I had the duty to come to the results pursuant to that agreement. And, of course, I had another duty—it may be a little more important. These Federal income tax returns were prepared under my direction, and I wanted to make doubly sure that nothing was misstated.

Q. Well, now, turning to Paragraph (D) 4, for example, "attributable to efficient selling as supervised by Mills," how would you define that term?

A. Well, again, that is dating back beyond my recollection, but I know all that was taken into account. We always comprehend a reasonable profit after we had ascertained the operating costs.

Q. Who was, then, to determine that reasonable profit?

A. That was determined by me in light of this agreement.

Q. Did you have anything to guide you, other than just the phrase, for example, "attributable to efficient selling as supervised by Mills"?

A. That is about all I can think of.

Q. In other words, then, it was just a pure matter of judgment as to what you thought that figure ought to be?

A. Well, yes, in the main. Because I had charge of the accounting, and I had certain rules and regulations that I had to watch to see that this group of companies that you refered to previously were dealt with fairly and reasonably.

Q. Mr. Stevens, have you ever had any experience in the technical manufacturing and finishing and processing of hosiery?

A. I never directed the estimates, but I know considerable about it, because I got into these things on many occasions, in working this cost finding system, both at Industries in Mississippi and also here in Indianapolis, and more especially the Realsilk Hosiery Mills. I had to get into the technical aspects of the industry.

Q. Now, you were not an employee, though, of National or Industries at any time, were you?

A. Well, I was called in to consult with them. I have forgotten who paid my fee check, but I did work for all the companies.

Q. Is that normal practice for an independent accountant to consult with management on technical problems of manufacturing, if that happens to be the business? Or not?

A. I would say no, except as they relate to cost finding methods and principles.

Q. Have you ever held yourself out as an expert in hosiery manufacturing?

A. The only connection I had, as I expressed it before, was with the Realsilk Hosiery Mills, and then later with National and others.

Q. Then your experience with Realsilk was in the accounting field, wasn't it?

A. Yes, and cost finding.

Q. And your experience with National was—?

A. As I say, in so far as I had to get into the technical operations of hosiery manufacture, in working out proper and necessary cost-finding methods.

Q. Now, calling your attention to Paragraph (D) 2, "attributable to low cost and efficient finishing as supervised by Mills," were you the one that was to be the judge of what constituted efficient finishing?

A. Of course, I could ascertain that from the cost records. If they were operating efficiently, we knew what the costs should be, because we had always prepared a budget in advance of our investigations relative to the actual cost of manufacture. And if we found that the actual figures corresponded to the budget, we said that they had done a good job in the operating division of the mill.

Q. I think if the reporter will read that question to you—

I don't believe you have addressed yourself quite to my original question there.

A. All right.

(The question referred to was read by the reporter as follows:

"Question: Now, calling your attention to Paragraph (D) 2, 'attributable to low cost and efficient finishing as supervised by Mills,' were you the one that was to be the judge of what constituted efficient finishing?")

The Witness:

Well, I am sorry to state that maybe I was. Because after all, I had the figures. I knew just what these different operations cost. I previously had set up a budget, and if they had met the budget and maybe gone a little under, they had done an efficient job. We endeavored to see that each division of the business got a fair profit and no more.

By Mr. Ponder:

Q. Calling your attention to Paragraph (D) 3 of Exhibit 37, reading, "Attributable to a fair and reasonable estimate of the value of any merchandising plans that have or shall have been developed by Mills," were you the judge of the amounts that were to be used in attributing income to that paragraph?

A. Well, I would say this, Mr. Ponder: that in matters of that kind, the selling and distributing costs, I did take and counsel other persons.

Q. Who would those other persons be?

A. Well, whoever I felt could throw some light on the problem that I was facing at the moment.

Q. Who were they?

A. Probably Mr. L. L. Goodman, and it could be that Mr. Kobin was in on it too. I don't recall. But I know this. I was given a very free hand in that record, for this reason. It hasn't come out heretofore. You see, these mills were borrowing money from time to time from the banks, and the banks wanted certified statements as to their financial condition. I recall distinctly on more than one occasion, I discussed the situation with loaning officers of two of the banks here in town and indirectly with one in New York, and I told them that I had complete knowledge and was unfettered when it came to carrying out an accounting policy, where each unit of the business would stand on its own two feet. And I even went so far in several of the years, probably all the years of the extant period, where I furnished certificates, accounting certificates, as to the accuracy of the accounts, certifying to the statement of financial condition and also the operating results. So, perforce, I had to be very careful that this was all set up so that there be

no inconsistencies within the corporation or between the corporations.

Q. Then would you state whether or not the figures which are shown as sales, cost of goods sold, appearing on the partnership return of Grenada Hosiery Mills, were the result of your determination of these various factors which you considered to be attributable to the provisions of the agreement? Is that true?

A. Exactly. They were.

Q. In other words, then, those figures were not actual figures of sales kept separate and distinct from, for example, sales of National? Is that right?

A. Well, we knew definitely—

Q. I am asking you on the sales now. Will you just address yourself to this question?

A. Yes. We always distinguished and tabulated the sales separately of the two aforementioned organizations.

Q. Now, coming to cost of goods sold, did you have a similar tabulation on cost of goods sold from actual records and not from any allocation or attribution?

A. From actual cost finding methods and records.

Q. Were the cost of goods sold figures shown on the returns taken from any actual invoices, vouchers, or other records, or were they constructed by virtue of your judgment and the entire records of National?

A. They were taken definitely from detailed tabulated records of sales, based on our cost finding methods.

Q. Those records that you refer to were National records. And your application or attribution was applied to those amounts? Is that right?

A. That is right. Well, we had, of course, our cost finding records at Mississippi. Often I would go down there and check when we couldn't reconcile the

figures, which was not often. We had, of course, complete records here in National, as it was a local operation, and Abar gave us no problem at all.

Q. Now, when this arrangement was first entered into with Hosiery, is it or is it not a fact that an attempt was made to separately segregate each service rendered from the time the grey hose were knitted by Industries, but that that attempt to segregate was later abandoned some time during the taxable period?

Mr. Littleton:

If Your Honor please, I think he is leading his witness too much.

Mr. Ponder:

Your Honor, I think it is obvious in this situation that certainly it is one of a hostile witness, and I don't think Mr. Littleton would seriously contend otherwise.

Mr. Littleton:

I don't want Mr. Ponder to lead, because he objects when I lead.

The Court:

Shall we say he is reluctant rather than hostile?

Mr. Ponder:

I would say this, Your Honor, that the record is already clear that Mr. Stevens, since January 1932—

Mr. Littleton:

I withdraw the objection.

Mr. Ponder:
I think the record is replete with enough facts to show the situation. I have tried to be restrained.

The Court:
You may proceed.

Mr. Ponder:
Would the Court prefer to take a recess at this time?

The Court:
I think this would be a good time to break.

(Short recess.)

By Mr. Ponder:
Q. Now, Mr. Stevens, I hand you Exhibit 9L, which is the partnership return filed by Grenada Hosiery Mills for the taxable period ended June 30, 1941, and I call your attention to line 14 thereof, which shows the amount of $82,908.44 as salaries and wages. Can you state exactly how that figure was arrived at? If it is necessary to refresh your recollection by reference to any of the books of entry, please do so.

In other words, can you find that figure on the records of Grenada Hosiery Mills? And if so, how was it recorded? Or was it a figure that is not on the books as such but was an allocation that you or somebody else under your supervision made?

A. I can refer to the books and answer that question.

Q. While you are doing that, I also call your attention to a figure down here on line 23, of $112.028.98, by "other deductions authorized by law"; and I will ask you in that connection while you are checking the books, whether or not that figure was taken from the books of National and was an allocation by you or somebody under your supervision of a figure shown on the books of National. In that connection, Mr. Stevens, you might also check the income items shown on that return and find supporting entries for those, too.

A. That item of $82,908.44, salaries and wages, on the partnership return, July 1, 1940 to June 30, 1941, Grenada Hosiery Mills, sales, consisted of salary to L. L. Goodman, $35,000, J. A. Goodman $35,000, H. V. Kobin $28,571.43, and office salaries, miscellaneous, $4,394.01. That doesn't quite equal that amount, but it is within about three dollars.

Q. Now, Mr. Stevens, do you know how the amounts that you have testified to as salaries of L. L. and J. A. Goodman and H. V. Kobin were arrived at, that were used in arriving at this figure on the return? Do you know how those salaries were arrived at?

A. Yes, by agreement and what they thought was a fair charge against the business.

Q. In other words, were you told to put those figures on the books as the salaries for those individuals?

A. That is correct.

Q. Now, calling your attention to the item that you mentioned there, $4,334.01 of office salaries, do you know whether or not Grenada Hosiery Mills, the partnership, had any office employees of its own?

A. I don't recall, but I can say that these were office salaries.

Q. Do you know how that figure was arrived at?

A. I would have to check. I don't know offhand.

Q. As being in charge of the books and records, can you testify whether or not Grenada Hosiery Mills' partnership had separate office employees who were not also employees of National or of Industries? In other words, any individuals who did not receive any moneys from National or from Industries?

A. I don't recall at the moment, except that this here would indicate that there must have been somebody paid on the Grenada Hosiery Mills payroll.

Q. Could that have been an allocation of amounts for employees of National?

A. It could have been.

Q. Who were doing certain services which were attributed to Hosiery Mills?

A. That could well be.

Q. Do you know whether or not that was the case?

A. I don't until I check.

Q. Do you know any way you can find out?

A. Yes. I think that would be ascertainable.

Q. While that other is being checked up on, I could ask some questions to save time.

I notice on the partnership return of income for the taxable period ended June 30, 1941, the item of merchandise bought for sale shown on that return. Now, do you know whether or not Grenada Hosiery Mills actually bought any merchandise from Industries or anybody else?

A. Whether Grenada Hosiery Mills bought from other than Industries?

Q. From Industries.

A. I would have to check that, too.

Q. In other words, you just don't know?

A. That is right.

Q. But you were responsible for putting that figure on the return?

A. That is right. Well, I could ascertain it by checking the records.

Q. When you are ascertaining that, you had better also ascertain the same question with respect to inventory.

Mr. Littleton:

If Your Honor please, I don't know what Mr. Ponder is striking at, but these are matters that I don't think the Court should concern itself with. They are covered by the examinations that have already gone on under the returns and under the agent's report. Now, this Court can't be made an auditor or hear testimony of that kind. We have the Commissioner's office, the agent's office, to do these things. Now, you are making a regular administrative office out of the Court. There is no question about these things. It has been passed over, and I don't mind having him bring it out, but there is a great deal of detail, and it is technical. It is a matter you have to sit down at the table on.

I think it is wholly immaterial to the issue here. We are terribly at a disadvantage in that respect, to go along here and justify what the Commissioner has already accepted in his report.

He has taken the gross income and the cost of goods as reported and found the gross profit from which our administrative expenses shall be deducted, and he has made certain adjustments in the deductions. Now,

he is making an administrative agency, an investigation agency, out of the Court, if Your Honor please.

The Court:

It seems to me that one of the crucial issues in this case is the role that Hosiery plays in the scheme of things. And I think that the line of examination that counsel is pursuing at this point is illuminating with respect to that question.

I will permit him to do so for that reason.

By Mr. Ponder:

Q. Then I will continue, and I will ask you, Mr. Stevens, if you know whether or not Hosiery Mills had any inventory of its own, in it's own name, during this taxable period.

A. I would have to look at the accounts to ascertain.

Q. Now, I am not referring entirely to accounts. I am asking you of your own knowledge whether in your association with National the amounts shown on the returns which you prepared, or which were prepared under your supervision, were actual amounts of inventory owned by Hosiery, or whether that figure is a computation or allocation made by you or somebody else of figures shown on National's books.

A. If I could look at the ledgers here, I could tell in a hurry. I wouldn't want to give snap judgment on it, because I don't recall.

Q. Then perhaps I will pass that until after that opportunity has been given during the noon period, and I will go into other matters that I could examine further.

But I want to come back to that after you have had a chance to look at your records.

A. There is one thing, Mr. Ponder. You gave me an agreement, here, a partnership agreement. Could I look at that again? No. 37?

Q. The one I gave you was between Industries and Hosiery Mills.

A. Yes.

Mr. Ponder:

Your Honor, I would like to correct a previous question I asked with respect to inventory. The figure I thought was inventory was carried over to the outside of the line and is not inventory but is the figure that I inquired about, of merchandise bought for sale. So you won't have to look into the inventory figure, Mr. Stevens. That is incorrect.

The Witness:

Mr. Ponder, you submitted this exhibit 37 to me, but I didn't look to see who the parties were.

However, I looked down here to the conditions, and I would like to restate my answer to your question.

Mr. Ponder:

Well, now, what question was that? I don't think that is proper. If counsel for Petitioner desires to question you about your previous testimony on cross-examination, I think that would be proper, but I have no further questions on that agreement at this time.

The Court:

That would be a more orderly way to proceed.

By Mr. Ponder:

Q. I will ask you this, Mr. Stevens: Do you know whether or not the sales which are reflected on the books of Grenada Hosiery Mills were recorded by the method of debiting National Hosiery and crediting sales? Do you know whether or not that was the method generally employed?

A. What set of books?

Q. That is on Grenada Hosiery Mills.

A. On Grenada Hosiery Mills' books?

Q. Yes.

A. When the sale was made, a debit was made to accounts receivable on the National Hosiery Mills' books.

Q. And what was the name of that account? Was that Grenada Industries, Inc. accounts receivable, or what?

A. It was accounts receivable—No, that was the customers' accounts. And then Grenada Hosiery Mills was given credit on that same set of books.

Q. Do you know whether or not it was true that when a check would be received by Mills—and we have had samples; you have been shown samples of the type by me—

A. By Hosiery Mills, you mean?

Q. When Hosiery Mills received a check from National. Now, have you got the picture?

A. Yes.

Q. Was the practice on the books to debit accounts receivable Grenada Industries and credit accounts receivable National? Now, was or was not that a fact?

A. I would have to review it, because these things here are old, and I can't say; but the records speak for themselves.

Q. That is right. I am just asking you. You were in charge of the records, weren't you?

A. That is right.

Q. And records were only kept as you directed?

A. That is right. But I don't recall just how that particular phase was handled. Because, you see, I handled many other accounts in addition to the Hosiery Mills accounts, and it is very difficult for me to answer from the witness stand a question of that character. But we can get the information.

Q. Rather than delay at this time, perhaps at the noon recess you will inquire into the method of the accountant, used on that point, when a check was received by Mills from National, as to what entries were then made at that time.

A. When the Hosiery Mills received a check from National?

Q. Yes. Whether or not the normal practice was to debit accounts receivable Grenada Industries, Inc. and credit accounts receivable National Hosiery.

A. I will work that out.

Mr. Ponder:

I think that I can ask a few more questions, and I will be through with this witness, except what he is going to check into the books on.

By Mr. Ponder:

Q. Mr. Stevens, are you the same Charles E. Stevens who is now shown to be, according to an exhibit already in the record, the trustee of certain trusts which are shown on the record as being partners in Grenada Hosiery Mills during this period and also stockholders of National and of Grenada Industries?

A. That is right.

Q. You are the same Charles E. Stevens? Are you the trustee of any trusts other than those which are either stockholders of National and Grenada or related organizations, as shown in the exhibit which is already in evidence? Are you trustee of any other trusts?

A. Other than shown in—

Q. In that exhibit, which at least you are familiar with?

A. I don't quite get the point of the question.

Q. I could enumerate about fifteen or twenty trusts.

A. Yes.

Q. Now, rather than do that, it might be simplified this way. They are all trusts for the benefit of either children of J. A. and L. L. Goodman or H. V. Kobin. Now, are you trustee of any other trusts except for the benefit of those children? Do you know?

A. During that period of '40 to '43? No. That states the case. Of course, there were other trusts.

Q. Yes.

A. For the benefit of other businesses. But as to these here, I am the C. E. Stevens that is named as a trustee.

Q. Are you trustee for any others than the children of L. L. Goodman, J. A. Goodman, or H. V. Kobin?

A. At this time?

Q. At this time.

A. Yes.

Q. Now, what trusts are they?

A. Well, I would have to enumerate those.

Q. Are they for other people? Are you trustee for others?

A. I am, yes, now.

Q. From '40 to '44?

A. No, that is all. But I would just like to get your question, Mr. Ponder. It is still a little uncertain whether I gave you the right response.

Q. Perhaps the best way would be to show you this exhibit and have you examine it.

I will hand you Exhibit 35-O, in which a number of trusts are listed. Your name is shown as successor trustee, in the last column. And I will ask you to examine that exhibit and state whether or not you are a trustee of any other trusts that aren't listed in that exhibit, or were, during the period '40 to '44, rather.

A. Yes, I was trustee of other trusts.

Q. For persons unrelated to either J. A. Goodman, L. L. Goodman, or H. V. Kobin?

A. No, they were those people.

Q. They were related to them?

A. Yes.

Q. You weren't trustee for any trusts that had no relationship to those people? Is that right or wrong?

A. Well, I was trustee of other trusts, of some of the children there, Elliot Goodman and others.

Q. But my question is: Were you trustee for any other children other than those of J. A. Goodman, L. L. Goodman, or H. V. Kobin?

A. No, I was not.

Q. Now, do you know whether or not at the end of each of the taxable years involved in this case, '40 to '44, there was prepared under your supervision a recapitulation sheet showing the total income of all of the business interests with which the Goodman and Kobin families were connected and showing the distribution of that income to either the members of that family or to trusts for the benefit of members of the family?

Now, do you know whether such a recapitulation was prepared at the end of each year?

A. Of those companies?

Q. That is right; with which J. A. and L. L. Goodman and H. V. Kobin were connected.

A. I would say that there was, but where it is now, I couldn't say.

Q. Do you know whether or not if that sheet showed a distribution other than 35 per cent to J. A. Goodman, 35 per cent to L. L. Goodman, 20 per cent to H. V. Kobin, and 10 per cent to A. J. Barskin, there was a later readjustment of income so as to produce an income to each of the families, or trusts for benefit of the families, in that proportion, at some later date?

A. I don't recall anything like that.

Mr. Ponder:

I believe that is all at this time, until he has had a chance to go into these records, Your Honor.

The Court:

Suppose we recess now and then come back a quarter of an hour earlier.

(Witness temporarily excused.)

The Court:

We will reconvene at quarter to two.

(Whereupon, at 12:15 o'clock p.m., a recess was taken until 1:45 o'clock p.m., this same day.)

Afternoon Session.

(The hearing was resumed at 1:45 o'clock p.m., upon the expiration of the recess.)

Mr. Ponder:
May I proceed, Your Honor?

The Court:
You may.

Whereupon CHARLES E. STEVENS resumed the stand and testified further as follows:

Direct Examination (Continued).

By Mr. Ponder:

Q. Mr. Stevens, just immediately before the noon recess, questions had been asked you with respect to figures appearing on the partnership return filed by Grenada Hosiery Mills for the period ended June 30, 1941, and I will ask you now whether you have had an opportunity to examine into the books and records and to ascertain the source of the figures about which there was inquiry; first, the merchandise-bought-for-sale figure, and then the figure of other deductions authorized by law, on line 23 of the return.

Have you had an opportunity to look into the books?

A. I have. And I have got the figures.

Q. Can you testify, Mr. Stevens, as to the source, that is, where those figures were obtained, that were put on the journal of the Grenada Hosiery Mills?

A. Yes.

Q. All right. Now, where was that?

A. To begin with, the merchandise bought for sale, which, as you refer to it, was the cost of sales, on this return for the year ended June 30, 1941—that was taken from the sales analysis of the product that was manufactured by the Grenada Industries.

Q. Now, who made that analysis which produced that figure?

A. That was made by one of the clerks in the accounting department.

Q. Was that under your supervision?

A. Yes, sir.

Q. Was that made from invoices of Grenada's goods that were sold by National salesmen?

A. That is right.

Q. Now, referring to the figure on line 23, other deductions, can you give us the source of that figure?

A. Yes. That was taken from the books of the Grenada Hosiery Mills, based on periodical charges for sales expense made by the National Silk Hosiery Mills. And there were some other items here, an amortization of prepaid selling expense. To state the figures, prepaid sales expense, $1557.73; sales expense, which was billed periodically, that is, every four weeks—

Q. Who was that billed by?

A. By the National Silk Hosiery Mills. That is $110,345.75. Dues, $.50. Legal and professional, $125. That all totals $112,028.98.

Q. Now, referring particularly to the figure that you have testified, there, to, as having been billed by National, what was the amount of that?

A. $110,345.75.

Q. All right. Now, do you know the source of that figure that was given to Hosiery Mills? That is, do you know how that figure was arrived at?

A. How it was determined?

Q. Yes.

A. Yes. In this way: The sales expense that was disbursed by National Silk Hosiery Mills was tabulated in their records periodically, that is, every four weeks.

Q. Now, are you speaking of total sales expense of National?

A. Yes. In the National ledger. Then, after that was tabulated, a determination was made as to the amount of sales made by Grenada Hosiery Mills, which was a Grenada Industries product, and the National Hosiery Mills product. A relationship was obtained from those figures, and that determined the amount that was allocated or distributable to Grenada Hosiery Mills.

Q. Who determined that relationship that was used in arriving at this figure?

A. That was based on a tabulation.

Q. Who made it?

A. It was made by the Accounting Department, some clerk in that department.

Q. And who gave that person the instructions as to how it should be done?

A. The head of the Accounting Department at that time. And that was further approved by myself.

Q. All right. Then, you know of your own knowledge what that relationship was. Now, that is what I want you to testify to. What was that relationship? In other words, what formula did you use in applying to the total expenses the sales expense of National, in order to arrive at this figure that is shown on the return of Grenada Hosiery Mills?

A. It is difficult to give it verbally, but here is the story, if you can grasp the theory. Let's assume that National Hosiery Mills on their accounts billed $100,000

in value of hosiery. Now, that consisted of, let's say, well, $50,000 of Grenada Hosiery Mills goods and $50,000 of National Hosiery Mills product. The expenses, the sales expenses, for that period, let's assume, totaled $2,000. Based on the relationship of the Grenada Hosiery Mills sales to the total sales, which was 50 per cent, in a like manner we took 50 per cent of that $2,000 expense and distributed it accordingly to Grenada Hosiery Mills; and the other 50 per cent, of course, was a National Silk Hosiery Mills sales expense item. And that appeared on their books.

Q. In the books and records of Grenada Hosiery Mills, were there such things as memo journal entries made?

A. Those entries were made periodically. When I say periodically, I mean every four weeks.

Q. Was there such a thing as a memo journal entry?

A. Just what do you mean by that?

Q. Were those entries made in Hosiery's books from memos which were given to the bookkeeper after the allocation was made, and those figures then entered on the books as per the figure on that memo?

A. That is right, yes. In other words, just so we understand each other, a tabulation was made of the sales every four-weekly period; and, depending on the dollar value ascribable to each company, there depended the amount of sales expense allocation.

Q. Then were the amounts shown as sales on the Hosiery books amounts which were given to the bookkeeper on a memo stating that those were sales to be attributed to Hosiery?

A. Yes. Well, let me say this, in furtherance. That was all based on a tabulation made of the in-

voice at the time it was put in the mails or at the time of shipment.

Q. Now, Mr. Stevens, I asked you during the noon reces as to the method of recording on the books of Hosiery Mills the sales which were attributed to Hosiery Mills. Now, have you had a chance to refresh your recollection? If I ask you the question as I do now, "Were sales recorded to Hosiery Mills recorded on the books of Mills by debiting National Hosiery and crediting sales?" can you now state whether that was the method used?

A. That was the method used.

Q. It was?

A. Yes, I checked that, and that is the amount that appears on this tax return, that you also asked about.

Q. Yes. Further, then, is it true or is it not true that when a check was received by Hosiery Mills from National, a journal entry would be made debiting accounts receivable Grenada Industries and crediting accounts receivable National Hosiery?

A. I am sorry. That is one of the things that I overlooked during this recess. But we can get that quickly.

Q. Well, if you could possibly; if that can be obtained quickly.

A. Here is an entry dated October 3, 1942 on the books of the Grenada Hosiery Mills, as follows: debit accounts payable Grenada Industries, Incorporated, $156,287.69. Credit accounts receivable National Hosiery Mills, the same amount.

The explanation: to record Check 5323 received from National Hosiery Mills, Inc. and indorsed to Grenada Industries.

Q. Now, can you testify whether or not that would be, then, the method that would be used to record checks received by Mills from National?

A. I would want to look over several additional entries similar to this, and I would say if there are three or four that either precede or follow this particular entry, that was the practice.

Q. Do you have the book there in your possession?

A. Yes.

Q. Could you quickly glance at two or three others to confirm or deny your conclusion?

A. Sorry to hold up the proceedings, but I forgot about that.

Mr. Littleton:

The practice, here, was that hosiery in the grey had the price determined from what the grey market was, would be shipped to National, and Industries would set up that amount as its sales of hosiery. National would finish that hosiery and determine the cost according to its operations, having a cost record book, following that hosiery through the processes of finishing, and the cost entailed, including its profit from those services, would be sent to the Bookkeeping Department, which would be rendered as an expense of finishing the hosiery for Industries. That would be set up as accounts receivable from Industries. And on Industries' books, it would be set up as accounts payable. As the hosiery was sold in its finished state, the amount of the sales price would be recorded as a receivable by National. It would charge itself and would be set up as a receivable to National and an accounts payable to Hosiery. National would credit that account with the selling expense that it

had incurred on behalf of Industries' or Hosiery's hosiery. That would be an account payable to it, or accounts receivable by it, from Hosiery; and it would be an accounts payable by Hosiery. And as National received the proceeds of sale, it would enter that up as cash received. It would eliminate the amounts or set up the amounts that Hosiery owed it and then send the check, its check, to Hosiery to settle the account.

There were periodical settlements of accounts, or credits on accounts. And Hosiery in turn would indorse that check and give Grenada Industries credit as set up from its purchases.

If checks were received at a time when Hosiery had settled its account with Industries, then that check would go into Hosiery's bank account and be used to pay its expenses.

And that is true the world over, Your Honor—

The Court:
This is what you are offering to stipulate?

Mr. Littleton:
Yes, that is what the records show.

Mr. Ponder:
Your Honor, I don't know, of course, the source of Mr. Littleton's information, other than the chief accountant officer of the company. He is here on the stand. I have been endeavoring for some time to obtain in the normal course of conduct the statement from him as to how these matters were handled.

Mr. Littleton:

If Your Honor please, I have an accountant here who could testify to that effect within fifteen minutes, where it would take Mr. Stevens two hours to do it.

Mr. Ponder:

As I say, if Mr. Stevens will be willing to testify, as the man in charge of the accounting system, that that is what happened, of course, I feel I would be bound by his testimony.

Mr. Littleton:

Is that true?

The Witness:

What you said is true.

Mr. Ponder:

That is all I have been trying to obtain from Mr. Stevens for a couple of hours without avail.

I have no further questions, then, of this witness.

Mr. Littleton:

That apparently closes the whole thing up.

Mr. Ponder:

From this witness, you mean?

Mr. Littleton:

Yes.

I was going to show, Your Honor, by taking up the returns of Industries for the period ended March 31, 1941 and the returns of Hosiery for the period ended

June 30, 1941, that from those returns, from Industries' sales reported by it on its return up to March 31, 1941, the grey price of hosiery plus the finishing cost that it invoiced to Hosiery from March 31, to June 30 would represent what is reported on Hosiery's returns as being the cost of the goods it sold.

If I might have the returns of Industries for the period ending March 31, 1941—?

The Court:
You are referring to Exhibit 5E?

Mr. Littleton:
That would be 5E, yes. It reports on its return gross return gross sales $1,607,696.70. That represents the price that it was charged for its grey hosiery, plus the finishing cost that was invoiced to it by National.

The Court:
Are you putting this as a question?

Mr. Littleton:
I am making a statement. And that would close this controversy.

Now, its actual cost of those reported sales would be $932,963.77, which would represent its manufacturing cost only. You see, it wouldn't be the finishing cost. The cost of sales as recorded on the return of Hosiery for the period ending June 30, 1941 would be $1,631,293.46, and that would represent the merchandise or the hosiery invoiced to it between March 31—in excess of what Industries reported—between March 31, 1941 and June 30. Now, those two figures are not

in accord, because of the fact that they had different years.

The cost of goods to Hosiery would be the grey price, as has been testified here, plus the finishing cost; so that it would be an in and out transaction so far as Industries was concerned. It would be moneys that it had actually spent, but which were refunded back to it. Then Hosiery would report the net proceeds of sale less any discounts from the trade, as reported to it by National from the sale of the specific merchandise manufactured by Industries of $1,933,429.92; so that it would come up with a gross profit of $302,132.46, from which would be deducted its administrative expenses and cost of sales, its proportionate cost of sales, coming down to its net profit.

Now, it was done that way to keep the record straight, so that each party would get its share of the profits in the merchandise as it was distributed to the trade. And the accounts were kept with accuracy and with detailed precision, so as to see that there would be no overlapping and that the merchandise of Industries would follow through, and it would have the profit. Its gross profit would be the cost of its manufacture of grey goods, or the price paid to it for its grey goods, less the cost of manufacturing those grey goods; and the accounts were kept with the same detailed accuracy and percision as they would be kept by the rankest kind of strangers.

The close relation in the related businesses had nothing to do with the shifting of accounts one from the other. And there was no shifting.

In the case of the sales expense, that was determined on the basis of the dollar sales of goods from Industries' merchandise; National's expense being determined on a daily basis of the salaries paid salesmen, the commissions paid, the salaries, and so on, and that was determined from what it had paid out. That was divided then between the dollar sales of Hosiery's goods and the dollar sales of National's goods. It was as accurate as if each one of them had a separate sales organization, and it was more economical to do it in that way.

Mr. Ponder:

Your Honor, I think that a good deal of that material in Mr. Littleton's statement could well be the subject of testimony if that is true. I am not objecting to his making any statements or comments, but in so far as there is no testimony to support it, that is another matter.

The Court:

To the extent that there is evidence to support it, I will treat his statement as merely explanatory of the evidence. I presume that he intends it only in that manner.

Mr. Littleton:

I take this position: that that statement is proved by the returns and the audits that have been made, and if it were not true, then the Commissioner would have picked it up in his audit, or should have picked it up.

The Court:

That is argumentative, of course.

Mr. Littleton:
I can prove it actually from the books, Your Honor, and verify it in the audits that have been made.

The Court:
I understand your position.

Mr. Littleton:
If those are not the true facts, then I would like to have the opportunity to put in the actual proof of those facts.

Mr. Ponder:
No further questions from this witness.

Mr. Littleton:
Are the facts that I have stated true?

Mr. Ponder:
I can't stipulate anything except what is in evidence.

Mr. Littleton:
If he is going to bust up his own audit—

Mr. Ponder:
Perhaps I should state this, Your Honor.

There is no dispute as far as I know that figures appearing on the returns that are in evidence were taken from books and records of the respective organizations.

The inquiry to which I have directed myself is the source of those figures appearing only on the Hosiery Mills returns; not that the figures can not be com-

piled from the returns, but the source, and where they came from, how they were put on the returns, and exactly how they got there.

Mr. Littleton:

Let me explain how they were put on Hosiery's books.

If Hosiery were to pay any part of the selling expense that was incurred by National, National would set up an accounts receivable and invoice Hosiery for it, and Hosiery would set up accounts payable, because it had to pay it out of the proceeds of sale. So there it came on to Hosiery's books from National's books, the same as it would have from Sears Roebuck's books or any others to which such sale was made. There has to be a record made on the books if we are to keep separate accounts.

The Court:

Counsel for the Commissioner was merely trying to establish, as I understand it, for the record, these very facts that you are now detailing, and it seems to me that that is all that is involved at this moment.

Mr. Littleton:

If that is true, the accouns came there from third party records. They didn't just come down out of the sky.

That is all, Mr. Stevens.

(Witness excused.)

Mr. Ponder:

I would like to recall Mr. L. L. Goodman for just a few questions.

Whereupon LAZURE L. GOODMAN was recalled as a witness and, having been previously duly sworn, was examined and testified further as follows:

Direct Examination.

By Mr. Ponder:

Q. Mr. Goodman, could you tell the Court who is Sarah W. Goodman?

A. The wife of my late brother.

Q. J. A. Goodman?

A. J. A. Goodman.

Q. Now, who is Florence S. Kobin?

A. The wife of Henry Kobin.

Q. Is Esther M. Goodman your wife?

A. Yes.

Q. Do you know whether or not the preferred stock of Industries was voting stock?

A. I think that in the State of Mississippi the preferred stock is voting stock.

Q. Now, did you take any part in arriving at the amount of salary which was shown as being paid to you and J. A. Goodman by Grenada Hosiery Mills for the taxable year ended June 30, 1941, about which there has been previous testimony here today? Did you take any part in the determination of how much that salary would be?

A. Yes. I expressed myself as to what I thought would be a fair salary for services rendered.

Q. Did anybody else participate in the decision as to how much those salaries would be?

A. Yes, others interested, the Board of Directors.

Q. I am speaking now of the Grenada Hosiery Mills.

A. Yes, the other partners expressed their opinion.

Q. Did Mr. J. A. Goodman take part?

A. Yes.

Q. Mr. Barskin?

A. Yes.

Q. Did Mr. Stevens take any part?

A. Yes, as representing the trusts. They were partners.

Q. Now, there are in evidence two exhibits bearing the designation of partnership agreements for Grenada Hosiery Mills and Abar Process Company.

In Exhibit 19, which is the Articles of Partnership of Grenada Hosiery Mills, paragraph (13) thereof states:

"The business policy of this partnership shall be determined by J. A. Goodman, trustee, L. L. Goodman, H. V. Kobin, trustee, and A. J. Barskin, each of whom shall have as many votes as the percentage of interest owned by him bears to the total interests of all partners."

Then further down in paragraph (13) it is stated:

"It is the sense of this agreement that the business policy of this partnership shall be determined by J. A. Goodman and L. L. Goodman and H. V. Kobin, so long as they act for the trusts owning an interest

in this partnership (or as Attorney-in-Fact in the case of H. V. Kobin), and by A. J. Barskin so long as he shall own an interest in such partnership, and that no heir, executor, administrator, successor or assign shall have any right to participate in the determination of such policy unless and until the remaining partners who still retain voting power shall in writing consent thereto."

Now, were you familiar with those provisions in the Articles of Partnership?

A. I was familiar at the time, and you asked me a while ago as to whether Mr. Stevens participated in those discussions. I should say "no," if he wasn't a trustee at that time. As I now recall, he became a trustee later.

Q. And when he was a trustee?

A. Then he had a right to participate.

Q. Referring to these quoted provisions, you were familiar with those at the time?

A. Yes.

Q. So far as you know, were those provisions carried out by the people that were named in the partnership with you?

A. Yes.

Q. Would that testimony also apply to a similar provision in the Articles of Partnership of Abar Process Company?

A. Yes. With one exception there. I think I might say, as it was pointed out in the testimony, that that agreement was amended later, I believe, to take care of a correction; because I was not a partner in my own name, L. L. Goodman, there, but was represent-

ing another partner, and that was corrected in an amendment to that agreement.

Q. In other words, you have to take into account the original agreement and the amendment to it?

A. Yes.

Q. And it was carried out in accordance with both?

A. Yes.

Q. Now, referring to your testimony a moment ago as to Mr. Stevens' being named successor or trustee of a number of trusts at a later date, I call your attention to Exhibit 35-O in evidence in this case and ask you whether you were familiar with the facts at the time when Mr. Stevens was named successor to the trustee in the Elliot R. Goodman Trust No. 2, as shown on this exhibit. Are you familiar with the circumstances surrounding that?

A. Yes.

Q. Did you have anything to do with his being named as successor trustee?

A. No, I think that that was the result of an appointment by the Court.

Q. You had no advance knowledge of any kind that he would be named successor trustee?

A. I think that I had information that his name was going to be presented to the Court, and the matter, as I understood, was entirely up to the Court to decide.

Q. As a matter of fact, didn't you have discussions about his being named as successor or trustee with your brother, Mr. J. A. Goodman, shortly before his appointment?

A. I presume that it would have been natural to discuss that, since we had previously been trustees before the Security Trust Company was named trustee; so that we had a natural continuing interest in it.

Q. Didn't you also discuss it with Mr. Kobin?

A. I don't think that I did. Maybe Mr. Mantell, who is our attorney, I believe may have acquainted Mr. Kobin with it.

Q. Did you discuss it with Mr. Mantell?

A. I think Mr. Mantell acquainted me with it.

Q. Were you aware that beginning in late 1942, Mr. Stevens became successor trustee to all of the trusts created by you, your brother, and Mr. Kobin?

A. Only in a general way.

Q. You knew that he was, though?

A. I knew that he was trustee for a number of trusts. I didn't know just exactly what trusts he was trustee for.

Q. Now, back to your testimony yesterday with respect to the cessation of active business by the Grenada Knitting Mills and the formation of the Grenada Hosiery Mills: Were you—

Mr. Littleton:

If Your Honor please, I think that has been covered in the previous examination. I don't see the necessity of going over it again.

The Court:

Let's see what the question is.

Mr. Ponder:

This is a point that I don't believe was brought out.

Mr. Littleton:

He can't go back and cross-examine this witness again. There has been no redirect on this issue. I don't care what he asks him. It can be answered truthfully and honestly. But I think he is just taking the time of the Court here to rehash these things again.

The Court:

State the question.

By Mr. Ponder:

Q. The question is: Did you participate or were you instrumental in that decision to change the form of the organization?

A. You mean the form of organization from Grenada Knitting Mills to Grenada Hosiery Mills?

Q. That is right.

A. I wouldn't say that I participated in it, other than as representing any trusts that I may have been trustee for. Matters of that kind, form of organization, were left up to our counsel. I made the statement yesterday that it had been brought to the attention of all interested parties that knew taxation laws were coming into effect, which would make it—I don't know whether I should say "less disadvantageous" to operate as a partnership than as a corporation. And to the extent that I had any authority I was asked for any consent or could legally have been asked for any consent, I am quite sure that I approved and followed the advice of the attorneys.

Mr. Ponder:

No further questions, Your Honor.

Cross-Examination.

By Mr. Littleton:

Q. Mr. Goodman, in fixing the salaries paid yourself and J. A. Goodman by Hosiery for its fiscal year ending June 30, 1941, did you take into consideration the reasonable value to the partnership of your services?

A. Yes, I did.

Q. You had been with the Realsilk Hosiery Mills for a good many years?

A. That is correct.

Q. What salary were you drawing from the Realsilk Hosiery Mills?

A. Oh, my salary in the Realsilk Hosiery Mills ranged all the way from $20,000 a year to $80,000 a year in various years.

Q. Did you feel that your services to Hosiery were worth as much as you fixed for your compensation?

A. I did.

Q. Did you feel that the amount that the Hosiery Company earned as a result of the services of yourself and your brother was reasonable in the trade, or the services it rendered in the sale of merchandising of National hosiery?

A. I did.

Mr. Ponder:

Your Honor, I object, on the ground that it is simply a self-serving declaration.

The Court:

I will let him answer that question.

The Witness:

I did.

By Mr. Littleton:

Q. Would you say from your experience in the hosiery industry that the net profit earned by the Hosiery for its various periods here involved was reasonable in the industry for the services it rendered in merchandising the hosiery of Industries?

Mr. Ponder:
I object on the same grounds.

The Court:
I will let him answer that.

The Witness:
Yes, I do, because in effect it cost Grenada Industries nothing. Because they were assured the sale of their output in the grey at top market prices, and that is all they were interested in, and for good reason.

For example, there has been discussion here about hosiery mills operating their own finishing plants or arranging themselves. Some one said they might get the goods finished and arrange to have it sold themselves or for their own account. That would give no assurance to Industries that it would operate any more profitably or even as profitably as operating as a grey mill.

The question that determines a mill, as to its policy, as to whether it is going to operate as a grey mill or as a complete finished mill, is not one of the amount of profit they are going to make from their operation, in the sense that just because they would sell their goods finished they would be assured of a higher profit than if they sold it in the grey. The chief purpose that a mill arranges to be a complete produce processor itself and do the finishing is to have a wider market for its hosiery. Because obviously you can sell a pair of stockings which is finished faster than you can sell one which isn't finished. I mean, anybody that sells hosiery that is finished can sell it to

20,000 retailers in the country. A mill that is selling hosiery in the grey can only sell it to the few hundred dealers that are willing to buy hosiery in the grey.

Now, in the Grenada Industries case, in making their arrangement with Grenada Hosiery Mills, they were assured by their arrangement with Hosiery Mills that they would have their output sold all the time, and that they would get top market price for their goods. They might have gone into finishing themselves and maybe sold their output, but they might have sold it at a point which didn't even cover their cost of finishing and their grey. They might have come off worse then had they sold their goods in the grey.

I think it is important that I clear up the fact that because a mill operates in the grey it doesn't mean that it operates at a substandard profit. It can operate at a normal profit if it can always sell goods in the grey.

There are mills in this country that have been operating as grey mills for the last thirty or forty years continuously and are satisfied to, because they can maybe find a satisfactory customer.

By Mr. Littleton:

Q. In some instances there is more profit in that than having a finishing mill?

A. Yes, and with less headaches.

Q. Does National Hosiery Associates, that succeeded Hosiery, perform for Hosiery about the same services that Hosiery performed for it back in this period?

A. Yes, it does.

Q. Identically, or substantially the same?

A. It buys its goods in the grey. It takes its entire output. They know they can run to capacity all the time.

Q. On the grey basis?

A. That is right.

Q. And isn't that true with reference to Batesville?

A. That is correct.

Along that line, as to further enlinghtenment, if I might, because I heard questions about Hosiery—did Hosiery buy the output of Industries, or wasn't it a selling agent: It wasn't a selling agent. A selling agent in the trade is some one who will undertake to sell the output of a mill at prices that the mill sets, but it doesn't guarantee that it is going to sell the output. And if they can't sell the output, that mill curtails, and its costs go up, and it may lose money.

Here is a case where Industries was guaranteed that their output would be sold.

The Court:

Was there a guarantee agreement between Industries and Hosiery?

The Witness:

In effect it was that, and that is why I said yesterday that the partners in Hosiery—while it didn't require much capital, they had substantial means to be able to perform in case the time came that money might have to be raised to help Industries out, if there were difficult times due to Hosiery not performing.

By Mr. Littleton:

Q. I believe you said yesterday, or you mentioned yesterday that hosiery was sold, Industries' hosiery, to Sears Roebuck, and that was a direct sale from Industries to Sears and Roebuck?

A. Yes.

Q. What percentage of the production of Industries in the grey did that represent in its first period of operation?

A. In the early stages, in the first year or so, I should say that it was variously from—

Q. Wait just a minute. Grenada Knitting Mills made that arrangement, did it not?

A. Yes.

I should say that at the start even as much as 50 per cent or more might have been delivered to Sears. Mr. Solar mentioned yesterday how these machines were set up one at a time, and production was very slow, and it was difficult getting this production up. In the year of 1938, on behalf of Grenada Knitting Mills, I personally took the buyer of Sears Roebuck to Grenada to show him the product that they were making, and worked out with him the merchandising ideas whereby he could sell this Grenada product, such as—I remember even drawing a sketch for him, of coining this name "Invisorib," meaning the ribs weren't visible, and making a sketch for him down at Grenada, which later on I saw he had his artist reproduce; and then they had a two-page spread in their spring catalogue in the spring of 1939 featuring this hosiery.

Now, they bought that hosiery there in probably August or September of 1938, for sale in January, in

their catalogue, which came out in January and February of 1939, and since it was such a big operation with them we had to give them preference and see that they got most of the first goods that we made, to satisfy their orders; which, of course, worked in very good in the plan of Grenada Knitting Mills in finding other customers for these Grenada goods, in that it is a known fact that one of the ways that you get a good price for any brand of hosiery is not to have too much of it to offer at any one time. And because Sears was taking such a large percentage at the start, it was easy for the National organization to say, "This is good hosiery, but we can only give you so much at the start," which made the customers all the more anxious to buy it and maintain those high price lines.

Q. Now, has Sears continued as a substantial customer of Hosiery, and today as a substantial customer of Associated or Industries' hosiery?

A. Yes, I should say today Sears is using more of Grenada's product than ever in their history, and they have continuously each year used more.

In the meantime, the Industries' plant has grown.

Q. Was that true during the time that Hosiery was merchandising the grey goods of Industries, in this period involved here?

A. That is true.

I think that you will find that already in evidence there are photostats of invoices rendered to Sears by Grenada Hosiery Mills. Naturally, Sears made those checks payable to Grenada Hosiery Mills, who in turn, probably, through bookkeeping transactions, trans-

fered over to National. That is a detail that maybe might clarify certain things.

Q. Well, did Hosiery at times receive direct checks from National payable to it?

A. Yes.

Q. It maintained a bank account?

A. Yes. All those checks that Hosiery received, it would turn over to National to put in their bank account, and later on National would add that to all other receipts it had gotten from any Grenada goods and then see that the right amount of money would eventually get back to Grenada Hosiery Mills.

Mr. Littleton:

That is all.

The Court:

I would like to ask the witness a question or two, if counsel are agreeable.

Mr. Littleton:

Yes, Your Honor.

The Court:

Mr. Goodman, assuming that the salaries that were paid by Hosiery to yourself and the others represent the fair value of the services rendered by you in connection with the various finishing operations and disposition and all the various operations which postdate the production in the grey of Industries' product—assuming that those salaries represent the fair value of those services, is it not true that it cost Industries more than just those salaries; that it cost Industries a sum over and above that which was paid to Hosiery,

and that was ultimately distributed to the partners of Hosiery? And doesn't that excess over the salaries, assuming that the salaries were a reasonable charge for the services that were performed for Industries' behalf, represent a siphoning off of Industries' profits to Hosiery?

The Witness:
No, sir.

The Court:
Well, would you explain that?

The Witness:
Yes. The value of the services rendered by Grenada Hosiery Mills was its net profit. If Hosiery Mills had wanted to place a value on the total services rendered—I mean, the services rendered of the officers who drew salaries would represent only part of the value of the services of the company.

The Court:
That is what I am trying to get at.

The Witness:
In other words, a company performs a function. We were employees of that company.

The Court:
In other words, if I may break in, what functions did the company perform over and above the services rendered by you and your brother and Mr. Kobin, who apparently was the third salaried employee involved?

The Witness:

Well, first, it furnished a responsible vehicle to do business with. It furnished a responsible party for Industries to do business with. If there had been any losses entailed, the partnership would have had to have been responsible for them. If, for example, the styling advice and merchandising advice that the officers of Knitting and the partnership gave to Industries had proved wrong, Industries would have had a proper claim against that partnership for redress.

The Court:

Is that true? Did the partnership undertake to warrant or to guarantee to save Industries harmless from loss if the styling advice or any other kind of service turned out in retrospect to be ineffectual or productive of loss?

The Witness:

No, there weren't those guarantees. There was the normal situation that exists between companies, and the unwritten rules of responsibility.

The Court:

What I am getting at is this: parenthetically, I am just trying to get at the facts.

The Witness:

You are trying to say that we didn't charge enough for our services? Maybe we didn't charge enough. Maybe we should have charged more. Maybe we were a little too generous in letting the company off as easily as we did.

The Court:

I am just trying to get the facts, and I may say parenthetically that I have formed no opinion whatsoever about the case at this point. I am just trying to get at the materials that will enable me to form a judgment.

The Witness:

I appreciate that. I am trying to be helpful.

The Court:

Thank you. Suppose there had been no partnership at all, and suppose Grenada Industries had been a corporation with which you had had no previous connection at all. Wouldn't you and your brother and Mr. Kobin have rendered services such as you did on behalf of this enterprise for such a corporation at the salaries that you took?

The Witness:

No, we could have sold our services at the open market for that much any day of the week, for what we charged.

The Court:

Then if you valued your services more than that, did you regard the excess as a kind of contribution, shall we say, to the partners of that partnership, who were to some extent the natural objects of your bounty?

The Witness:

I would say that we were not unmindful of the fact that benefits that would be accrued would fall into friendly hands.

There is no doubt about that.

The Court:

But you feel that the salaries you were paid were considerably below what might have been paid in an open market and dealings with strangers? Is that a fair description?

The Witness:

I don't think that Industries could have gotten our services for those salaries, or any other concern that would have gotten those particular services.

I think also that part of the satisfaction that we got out of it was the satisfaction of seeing our ideas that we believed in developed.

It was quite a trick to take a stocking that cost the same as any stocking and to price it up a price line higher and make the public grab for it at a higher price, because it made them appreciate it more. It is the same way as an artist likes to paint a good picture. There is a certain thrill in doing a merchandising job.

The Court:

What is troubling me—and perhaps I am just restating something that I have already inquired about—is that assuming that the salaries that were received represent the fair value of the services rendered, I find great difficulty in finding at all that the partnership contributed over and above the contributions of what for want of a better term I shall describe as the dominant employees. You answered that already by indicating that they represented a certain amount of responsibility as far as capital was concerned.

I have heard your answer, and I think I know what the words mean, and yet they don't seem to ring a bell with me.

I just can't visualize a situation that would probably arise in which they would be called upon for capital advances.

The Witness:

Well, first I will go back a bit to one of your other questions. You are talking about the fair price for those services, our services. I would say that it was fair, that what we charged for our services was fair, in the sense that we did not want to overcharge the company for our services. We didn't want to be criticized. We have heard so many people criticized in companies and corporations for drawing excessive salaries. And so it was fair in the sense that we knew that it wasn't unfair to the partnership. Some one could have put up a good argument that we would have been justified in receiving considerably larger salaries.

The Court:

But you felt that while they were worth so much to the partnership, they were worth a good deal more to Industries?

The Witness:

Yes.

The Court:

I am just trying to find out how you bridge that gap.

The Witness:

It was worth a good deal more to Industries, because, first of all, had Industries gone to New York and hired some people to do this job on a pay basis, they would never have gotten the benefit of, if I may modestly make this statement, the genius employed. They might have got somebody who would have given them what you might have considered an orthodox job, which would have been competent, but it wouldn't have benefited Industies to the extent that it would have given them the security that it got in its relationship to Hosiery, the security of its ability to sell its output continuously, on account of the fact that Hosiery arranged to sell these goods on a merchandising plan which brought repeat business.

Today, Sears Roebuck is still using that hosiery and in much larger volume than the very first day that they bought it, and here ten years have gone by.

So it was not just a case of having sold the output that particular year in question, or the years in question, but it was sold in a way that it made sound distribution and got the hosiery into logical hands, those of people who would be logical purchasers of, say, high priced hosiery; such as is indicated in the fact that we realized if we were to sell higher priced hosiery it had to be sold in the big cities, because they only would use high priced hosiery. So there would be three accounts instead of one in a big city, but it had to be handled in such a way that each of those accounts would promote the sale of that hosiery as if it were the only account in town that had that hosiery. That all resulted in security on the part of Industries in

knowing it could always sell its output and it could always sell its output in the grey market prices.

The Court:

By "security," do you mean not contractual security but rather security based upon the reasonable expectation that so long as you and your brother were dominant in the affairs of Hosiery, shall we say—

The Witness:

But it got past that point in a few years, Your Honor, because once the brand got established and the public repeated on it, it from then on went on its own momentum.

The Court:

It went on its own. I see.

Thank you very much.

(Witness excused.)

Mr. Ponder:

Your Honor, counsel for Petitioner and I have agreed that I can have identified and offer in evidence seven trust instruments, being trusts which are record stock owners of either National or Grenada Industries stock, which are not previously in the record. Other trust instruments have gone in of trusts which are listed as partners.

Now, if I may, we will call these joint exhibits. I hand these seven to the Clerk and ask him to mark these as the next seven joint exhibit numbers. Or

I should say that we now jointly offer them in evidence.

Mr. Littleton:

They being the stockholders of Industries and National other than the individuals.

The Court:

They may be received.

(Joint Exhibits 41V, 42W, 43X, 44Y, 45Z, 46AA, and 47BB, were received in evidence.)

Mr. Ponder:

Also with the same understanding, I have the partnership income tax returns filed by Grenada Hosiery Mills Machinery. This is the organization composed of J. A. and L. L. Goodman, which leased the machinery to Grenada Industries, Inc. Now, I have these returns for the years ending March 31, 1940, and March 31, 1942, '43, and '44. I do not have the return at hand ending March 31, 1941, so we just don't have that return available. And that can be either joint or separate.

Mr. Littleton:

It can be joint.

Mr. Ponder:

Joint exhibits, then. If these may be marked for identification and offered in evidence as joint exhibits, to allow the seven trust instruments which have just been offered—

The Court:
They may be admitted.

(Joint Exhibits 48CC, 49DD, 50EE, and 51FF, were received in evidence.)

Mr. Ponder:
And with respect to all the returns, Your Honor, I think, as has been mentioned previously, I would like the privilege, if the Court will plermit, of withdrawing the original returns and substituting photostats.

The Court:
You may do so.

Mr. Ponder:
Respondent rests, Your Honor.

Mr. Littleton:
That is all the evidence that the Petitioner desires to offer.

The Court:
Are counsel ready to submit the case, then?

Mr. Littleton:
It will be submitted, yes.

Now, with reference to briefs, Your Honor, I understand that the rule is forty-five days for major briefs and fifteen or twenty for reply. I think this probably should be the other way around, sixty days for plaintiff and thirty days for the respondent, and then ten or fifteen days to reply to respondent.

The Court:

I should think that you could get a brief in in forty-five days.

Mr. Littleton:

I can do it, Your Honor. That would be simultaneous briefs?

The Court:

No, I prefer not to have simultaneous briefs.

Mr. Littleton:

I will try. your Honor, within that time, and if I don't, if something interferes with me, I will ask the indulgence of the Court for the extension.

The Court:

Suppose we set forty-five days for the Petitioner's brief, twenty days thereafter for Respondent's brief, and if Petitioner desires to reply he may do so fifteen days thereafter.

Mr. Ponder:

Your Honor, if possible, I would like to ask for at least thirty days. I would like to explain that when the briefs are filed, when Petitioner's brief is filed on the consecutive system, there is normally a period from five to eight days before the brief is received by me, and that, of course, takes up part of my time.

The Court:

In view of the complexity of this case, I will allow you thirty days.

Mr. Littleton:

If your Honor please, the record won't be received until fifteen days, and that will cut us down considerably on that. We can't start until we get our record.

The Court:

I will adhere to the time that I have already given you. If you have legitimate reason at the end of that time for not being able to get it in, I will entertain a request for an extension.

I would like to ask counsel to direct their attention in their briefs to one point that has been bobbing up now and then during the trial, and that point relates to the burden of proof.

I inquired this morning about what proof there was or might be in the trial with respect to an allocation in the event that I should reach the conclusion that the situation called for an allocation.

Mr. Ponder indicated that it was the Government's position that once the necessity for an allocation had been shown, the burden of proof there upon shifted to the taxpayer.

Mr. Littletion indicated that if it were shown that the allocation in fact attempted by the Commissioner were arbitrary or did not follow the appropriate breakdown of figures, then the burden rested upon the Commissioner to justify some type of allocation.

These are points of view that I think are squarely in conflict with each other. And while I ask for no

argument at all on them at this point, I hope that counsel will consider them in preparing the briefs. I presume that one of the principal cases involved that should be discussed is Helvering against Taylor in the 293rd volume of the Supreme Court Reports, and I would like to have some discussion as to the applicability of the rule which that case is sometimes thought to represent.

Mr. Ponder:
Very well, your Honor.

The Court:
The case is submitted.

We will have a ten-minute recess and then we will proceed with the next case.

(Whereupon, at 3:00 o'clock p. m., Thursday, November 2, 1950, the hearing in the above-entitled matter was closed.)

STIPULATION REGARDING VENUE ON REVIEW

Filed May 23 1952.

United States Court of Appeals For The Fifth Circuit
Grenada Industries, Inc., Petitioner,
v. Docket No. 24571
Commissioner of Internal Revenue, Respondent.

Pursuant to Section 1141 (b) (2) of the Internal Revenue Code, it is hereby stipulated and agreed by

counsel for the respective parties that the decision of The Tax Court of the United States in the above- entitled proceeding entered March 6, 1952, may be reviewed by the United States Court of Appeals for the Fifth Circuit.

ROBERT A. LITTLETON,
(Robert A. Littleton),
Attorney for Petitioner.
ELLIS N. SLACK,
(Ellis N. Slack),
Acting Assistant Attorney General, Attorney for Respondent.

PETITION FOR REVIEW OF DECISION OF THE TAX COURT OF THE UNITED STATES (DISTRICT OF MISSISSIPPI).

United States Court of Appeals Fifth Circuit

Filed May 27 1952.

Grenada Industries, Inc., Petitioner
vs.
Commissioner of Internal Revenue, Respondent

Tax Court Docket No. 24571

I.

The petitioner, Grenada Industries, Inc., is a corporation existing and organized under the laws of Mississippi, with principal office and place of business at Grenada, Mississippi. For the fiscal years ending March 31, 1941; March 31, 1942; and March

31, 1943 petitioner filed its Corporation Income and Excess Profits Tax Returns with the office of the Collector of Internal Revenue for the Collection District of Mississippi at Jackson; but for the fiscal year ending March 31, 1944, petitioner's Income and Excess Profits Tax Return was filed "for processing by the Bureau of Internal Revenue" with the office of Collector of Internal Revenue for the Collection District of Indiana. The respondent is the duly qualified and acting Commissioner of Internal Revenue of the United States; and as such official of the Bureau of Internal Revenue, supervises the audit of returns filed by petitioner as aforesaid with respect to taxable income derived from the conduct of its business carried on in the Collection District of its domicile at Grenada, Mississippi. Petitioner has no other place of business than at Grenada, Mississippi.

II.

On or about June 2nd, 1949 the respondent mailed to petitioner a deficiency notice proposing to assess deficiencies in Income, Declared Value Excess Profits, and Excess Profits Taxes for said fiscal years ending March 31, 1941; March 31, 1942; March 31, 1943; and March 31, 1944 in the aggregate amount of $210,367.31. Petitioner duly appealed from said notice of deficiencies of June 2nd, 1949 to The Tax Court of the United States for a de novo review by that tribunal of the determination proposed by respondent.

III.

In The Tax Court of the United States the contested issued were confined to the proposal of respondent to allocate to the petitioner and consolidate

with its "net income" a substantial portion of the "net income" of Grenada Hosiery Mills, a partnership, and Abar Process Company, also a partnership, as a basis for the major portion of the proposed deficiencies. The proceeding was duly and formally heard by a Division of The Tax Court of the United State, and on August 22, 1951, that tribunal promulgated its finding of fact and opinion approved the amounts of deficiencies in tax proposed by respondent, with the exception of the tax resulting from the allocation to the petitioner of net income of Abar Process Company; but in doing so The Tax Court assigns a reason for its conclusions on the contested issues different from that stated by respondent in the deficiency notice as a basis for his determination.

Grenada Hosiery Mills was, as The Tax Court held, a bona fide partnership engaged in business in several of the recognized separate and distinct phases of the ladies' full fashioned hosiery industry, different and separate from the phase of the industry in which the petitioner was engaged. The net income of Grenada Hosiery Mills, which is allocated to petitioner, was earned by Grenada Hosiery Mills in the performance of the separate duties, services and activities required of it pursuant to the joint enterprise arrangement between petitioner and Grenada Hosiery Mills under the terms of the agreement of June 24, 1940, having to do with the production of hosiery in the grey by the petitioner and with the styling, finishing, merchandising and selling thereof by Grenada Hosiery Mills. The joint enterprise arrangement between petitioner and Grenada Hosiery Mills was to continue, and did continue, under the agreement for

a period of five years from and after June 30 1940; there was no overlapping of the separate services of each in the styling of hosiery by Grenada Hosiery Mills, its production by petitioner in the grey, and the finishing processes and sale thereof by Grenada Hosiery as provided by said agreement. This joint enterprise began in 1938 between the petitioner and Grenada Knitting Mills, Inc., which latter corporation was succeeded on June 30, 1940 by the Grenada Hosiery Mills partnership; at no time during the period under review, or prior thereto, was petitioner in a position to preform the services to the joint enterprise that were required of Grenada Knitting Mills, Inc. prior to June 30, 1940 and/or Grenada Hosiery Mills pursuant to the agreement of June 24, 1940; during all of said times the petitioner was equipped only as a gray mill for the production of hosiery in the unfinished gray stage.

IV.

Pursuant to a recalculation of deficiencies in taxes aforesaid, and the stipulation of parties, as to the amount thereof for settlement under Rule 50 of The Tax Court, the Court entered a final order on March 6, 1952, fixing the amount of deficiencies in Income, Declared Value Excess Profits, and Excess Profits Taxes as follows:

Year	Kind of Tax	Deficiency
3/31/41	Income	$25.019.41
	D/V Excess Profits	10,265.16
	Excess Profits	13,176.95
3/31/42	Income	13,750.49
	Excess Profits	11,475.52

Year	Kind of Tax	Deficiency
3/31/43	Income	5,931.66
	Excess Profits	20,338.67
3/31/44	Income	9,060.03
	Excess Profits	27,365.64

V.

Petitioner is aggrieved by the decision of The Tax Court of the United States entered as aforesaid March 6, 1952, and within the meaning of Sections 1141 and 1142, Title 26 USCA (Sections 1141 and 1142 Internal Revenue Code, as amended) the decision is reviewable by the United States Court of Appeals for the Fifth Circuit.

VI.

In making and entering its decision herein, The Tax Court of the United States committed errors in the following respects:

(a) By approving resultant deficiencies in tax arbitrarily and capriciously proposed by respondent against petitioner for the years in question and computed by the hybrid and unauthorized method of consolidating with the net income of petitioner a substanial portion of the net income of Grenada Hosiery Mills, another trade or business which the Court finds and holds to be an independent trade or business from that of petitioner.

(b) By erroneously interpreting the witten contract of June 24, 1940 between the petitioner and Grenada Hosiery Mills as consituting the petitioner the sole

enterpriser thereunder for the production and sale of finished hosiery and as providing for certain services to be rendered by Grenada Hosiery Mills "to the petitioner" at a "fair charge"[1] and by failing properly to interpre the contract in accordance with its manifest intent, and with the practical interpretation given thereto by the parties, to the effect that it constituted the petitioner and Grenada Hosiery Mills as members of a joint enterprise for the production and sale of finishing hosiery, each assigned by the agreement to perform the particular phase, or phases, thereof for which it was equipped and in which it was engaged, and consituting them as joint earners of the income from the joint enterprise.

(c) By failing to recognize the clear right of the parties to the contract of June 24, 1940 to interpret and apply its terms in the practical manner in which they did, consistently and uniformly throughout the life of the contract, to the effect that the gross receipts from sale of the finished hosiery by Grenada Hosiery Mills should be applied by it—(1) to paying petitioner, upon gillings from the petitioner, amounts equivalent to the top market price per dozen for hosiery in the unfinished gray stage to which the petitioner produced the hosiery, plus an amount equal to the cost of finishing the gray hosiery charged by National Hosiery Mills, Inc., and billed to the petitioner; (2) to paying all expenses incurred by Grenada Hosiery Mills incident to the separate services rendered by it to the joint enterprise; and (3) the remainder, if any, of the receipts to be kept by Grenada Hosiery Mills as and for its own net earnings from the joint enterprise.

[1] The quoted words being those of The Tax Court.

(d) By finding and holding that the net income allocated from Grenada Hosiery Mills to the petitioner was earned by the petitioner, and that the services performed by Grenada Hosiery Mills were not worth more than its cost of rendering them, all without any evidence to support the same.

(e) By holding that petitioner may not make a contract to manufacture unfinished gray hosiery and receive therefor the prevailing market price for gray hosiery when produced, without assuming the tax burden on a substantial portion of the profits realized by another trade or business when the gray hosiery produced by petitioner is subsequently finished and sold by the other trade or business to its customers at a price above the sum of the prevailing gray market price payable to petitioner, finishing cost and cost of sale.

(f) By imposing on petitioner the duly to engage in and/or extend its business activity in the hosiery industry to a phase thereof that petitioner was not equipped to perform, or suffer the burden of tax on a substantial portion of net profits realized by another and earned because of its business acumen and qualification to engage in a phase of commerce and trade not engaged in by petitioner; and by imputing to petitioner a "material benefit" that results to another trade or business from the services of its employees; and arbitrarily allocating to petitioner the tax burden on gains that petitioner did not earn, has no right to enjoy, and may not reduce to its possession.

(g) By holding, upon the facts found from the evidence, that petitioner and Grenada Hosiery Mills are owned and controlled by the same interests, within the meaning of Section 45 IRC.

(h) The decision of The Tax Court is not supported by any substantial evidence, and it appears erroneous on all of the evidence.

VII.

The foregoing errors of The Tax Court are made apparent and inescapably manifest by a summary of its findings of facts, opinion and substantial evidence of record to the effect,—

(a) That Grenada Hosiery Mills, a partnership, functioned as an entity in the hosiery industry separate and apart from petitioner in the business of styling hosiery in the process of knitting; supervising the finishing process; and merchandising the finished hosiery.

(b) That Grenada Hosiery Mills was a valid partnership and actually carried on business as an independent entity in the phase of the hosiery industry engaged in by it.

(c) That Grenada Hosiery Mills supplied the indispensable services of styling and merchandising the gray hosiery produced by petitioner; and directed the sale thereof to the trade at prices fixed by Grenada Hosiery Mills after finished by National Hosiery Mills, Inc. under the supervision of Grenada Hosiery

Mills; all under and pursuant to the contract of 1940 which is set out in the findings; and

(d) That upon the record, there is no basis for disregarding the separate entity of Grenada Hosiery Mills for income tax purposes or for any other purpose.

(e) That employees of Grenada Hosiery Mills, who directed its business policies, were not owners of an interest in petitioner; and that there are no adjustings necessary in the accounting records of each such trades or businesses (within the meaning of Section 45 IRC) in order to clearly reflect the net income of each and/or prevent evasion of tax.

VIII.

The error that is paramount in the decision of The Tax Court is due to the Court's arbitrary and capricious application of Section 45 IRC to a scheme of taxation not contemplated by its purpose; and when The Tax Court attempts to prescribe the fair market price at which petitional may dispose of gray hosiery, by concentrating in its profit an dloss statement a substantial portion of the profit realized by another from the subsequent processing work thereof and the handling thereof for sale to the trade, the Court abuses rather than administers the provisions of Section 45 IRC as a basis of its decision. The Tax Court does not, nor did respondent in his deficiency notice, purport to distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among two or more organizations, trades or businesses for the purpose of preventing evasion of

taxes or clearly to reflect the income of any such trades or business; but rather, the respondent (as well as the Court) proposes to concentrate the net profits of each of two trades or business into the pofits of each account of petitioner by the method of consolidation. The Court finds and holds that the styling and merchandising services that Grenada Hosiery Mills performed were services of substantial value in that phase of the hosiery industry; but in the aspect that profits may accrue therefrom to a trade or business rendering such services, The Tax Court decides that in the case of Grenada Hosiery Mills a substantial proportion of the profits it earned are allocable as net income of petitioner. The theory of The Tax Court seems to be that petitioner should have equipped itself to carry on the business of Grenada Hosiery Mills; and in the event petitioner had done so, it could have employed the persons whom Gernada Hosiery Mills employed to carry on its business. Therefore, it is assumed by the Court that petitioner might have earned profits substantially in the proportion earned by Grenada Hosiery Mills. Such an assumption by the Court is not in accordance with the provisions of Section 45 IRC; it is basically wrong as a matter of law, and is drawn from facts that prove the inability of petitioner to carry on the type of business engaged in by Grenada Hosiery Mills that was of substantial value to its owners. The allocation of a substantial portion of the net income of Grenada Hosiery Mills as net income of petitioner is arbitrary and capricious under the basic purpose of the Internal Revenue Code "that those who earn and own income from a trade or business must bear the burden of tax thereon". Petitioner has no right or claim to net income of Grenada Hosiery Mills and it should not

(under the provisions of Section 45 IRC) be burdened with tax on a substantial portion thereof, as proposed by respondent and/or determined by The Tax Court.

IX.

The order and decision of The Tax Court of March 6, 1952 is not supported by any substantial evidence; but rather, it is contrary to all the evidence and not in accordance with law.

X

WHEREFORE, petitioner prays:

(1) That this Honorable Court review the decision and order of The Tax Court of the United States entered herein on the 6th day of March, 1952, to the end that the deficiency tax liability of petitioner for the years in question be authoritatively adjudicated, decided and settled in accordance with law.

(2) That the decision of The Tax Court be reversed; and

(3) That petitioner be granted such other and further relief in the premises as the nature of the case may admit and to this Honorable Court may seem meet and proper.

ROBERT A. LITTLETON
(Robert A. Littleton),
Attorney for Petitioner.

1021 Tower Building,
Washington, D. C.
Of Counsel:
GILLIOM, ARMSTRONG AND GILLIOM,
ARTHUR L. GILLIOM,
1340-1344 Consolidated Building
Indianapolis, Indiana.

United States of America,
District of Columbia, ss.

Robert A. Littleton, being duly sworn, says that he is attorney for petitioner in the above-entitled matter; that he has read said petition and is familiar with the contents thereof, that said petition is true of his own knowledge except as the matters therein alleged on information and belief, and as to those matters he believes it to be true.

ROBERT A. LITTLETON.

Subscribed and sworn to before me this 27th day of May, 1952.

(S.) ELIZABETH LAMBDEN,
Notary Public, D. C.

(Seal)

My Commission Expires Aug. 31, 1952.

NOTICE.

Filed May 27, 1952.

United States Court of Appeals, Fifth Circuit.

Grenada Industries, Inc., Petitioner,
vs. T. C. Docket No. 24571
Commissioner of Internal Revenue, Respondent.

To Commissioner of Internal Revenue,
Bureau of Internal Revenue,
Washington, D. C.

Dear Sir:

You are hereby notified that petitioner in the above-entitled proceedings has this day filed with The Tax Court of the United States a petition to review the decision of The Tax Court entered herein on March 6,

1952, together with assignment of error and/or points relied upon by the United States Court of Appeals for the Fifth Circuit pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

Will you please acknowledge service of this notice, together with receipt of copy of petition as indicated below.

Dated at Washington, D. C., this the 27th day of May, 1952.

ROBERT A. LITTLETON,
(Robert A. Littleton),
Attorney for Petitioner.

1021 Tower Building,
Washington, D. C.

Service of the foregoing notice, together with receipt of copy of petition to review, is acknowledged this the 27th day of May, 1952.

CHARLES N. DAVIS. CAR.
Attorney for Respondent.

ORDER RE CONSOLIDATION AND TRANSMISSION OF TESTIMONY AND ORIGINAL EXHIBITS BEFORE THE TAX COURT OF THE UNITED STATES.

Filed June 25, 1952.

In the United States Court of Appeals, for the Fifth Circuit.

Grenada Industries, Inc., Petitioner,
vs. TC No. 24,571
Commissioner of Internal Revenue, Respondent,
and
Commissioner of Internal Revenue, Petitioner,
vs. TC No. 24,640
National Hosiery Mills, Inc., Respondent.

Upon consideration of the motion filed herein by the parties in the above entitled proceedings for consolidation and transmission of testimony, together with original exhibits before The Tax Court of the United States, it is, this 23rd day of June, 1952 Ordered:

First,—That the Clerk of The Tax Court of the United States shall certify and transmit to this Court a single consolidated transcript of record on review in the above entitled proceedings; and that these proceedings be and they are hereby consolidated for briefing, hearing, argument and decision.

Second,—That a certified copy of transcript of the testimony taken before the Honorable Arnold Raum, Judge of The Tax Court of the United States, at Indianapolis, Indiana, on October 31st and November 1st and 2nd, 1950 be transmitted to the Court of Appeals

for the Fifth Circuit in place of the statement of evidence as required by Rule 37(2).

Third,—That the original of joint exhibits; the original of exhibits of petitioner and/or respondents, as the case may be, as designated by the parties, may be transmitted by the Clerk of The Tax Court to the Clerk of this Court in lieu of being set forth in the transcript of record to be certified by the Clerk of The Tax Court of the United States to the Clerk of the United States Court of Appeals for the Fifth Circuit. However, said exhibits to remain in the custody of the Clerk of The Tax Court until ten days prior to the hearing before this Court and upon direction of counsel for the parties to be then transmitted by the Clerk of The Tax Court to this Clerk of this Court.

Fourth,—That said exhibits, as designated by parties, need not be printed in the record on review herein but may be referred to by counsel in their respective briefs and on oral argument; or reproduced, in whole or in part, in an appendix to briefs for the respective parties, and considered by the Court with the same force and effect as if included in the printed record on review.

Fifth,—That the Clerk of this Court transmit a certified copy of this Order to the Clerk of The Tax Court of the United States to be incorporated in the transcript of record on review herein.

Dated this 23rd day of June, 1952.

(S.) WAYNE G. BORAH,
U. S. Circuit Judge, Fifth Circuit.

(Seal)

Attest:

Clerk's Office:—

A True Copy:

(Signed) OAKLEY F. DODD,
Clerk, U. S. Court of Appeals, for the Fifth Circuit.

Now Orleans, Louisiana, June 23, 1952.

MOTION FOR CONSOLIDATION AND TRANSMISSION OF TESTIMONY AND ORIGINAL EXHIBITS BEFORE THE TAX COURT OF THE UNITED STATES.

In the United States Court of Appeals, for the Fifth Circuit.

Grenada Industries, Inc., Petitioner,
vs. TC Docket No. 24,571
Commissioner of Internal Revenue, Respondent.
and
Commissioner of Internal Revenue, Petitioner,
vs. TC Docket No. 24,640
National Hosiery Mills, Inc., Respondent.

Come now the petitioners on review, by their respective counsel, and move:

First,—That the Clerk of The Tax Court of the United States be directed to certify and transmit to this Court a single consolidated transcript of record on review in the above entitled proceedings; and that these proceedings be consolidated for briefing, hearing, argument and decision.

Second,—That a certified copy of the transcript of the testimony taken before the Honorable Arnold Raum, Judge of The Tax Court of the United States, at Indianapolis, Indiana, on October 31st and November 1st and 2nd, 1950 be transmitted to the Court of Appeals for the Fifth Circuit in place of the statement of evidence as required by Rule 37(2).

This,—That the original of joint exhibits; the original of petitioner's exhibits, and the original of respondent's exhibits (as designated by parties) instead of being fully set forth in the transcript to be certified by the Clerk of The Tax Court of the United States to the Clerk of the United States Court of Appeals for the Fifth Circuit, may be transmitted by the Clerk of The Tax Court to the Clerk of this Court. Said exhibits, however, to remain in the custody of the Clerk of The Tax Court until ten days prior to the hearing before this Court; and, upon direction of counsel for the petitioners, to be then transmitted by the Clerk of The Tax Court to the Clerk of this Court.

Fourth,—That exhibits, aforesaid, need not be printed in the record on review herein, but may be referred to by counsel in their respective briefs and on oral argument; or, reproduced in whole or in part, in an appendix to respective briefs of parties and con-

sidered by the Court with the same force and effect as if included in the printed record on review.

Fifth,—That the Clerk of this Court be instructed to transmit to the Clerk of The Tax Court of the United States, Washington, D. C., a certified copy of the order entered herein to be by him incorporated in the transcript of record filed in this Court.

(Signed) ROBERT A. LITTLETON,
(Robert A. Littleton),

1021 Tower Building,
Washington, D. C.

Attorney for Petitioner,
GRENADA INDUSTRIES,
INC.
and for Resondent,
NATIONAL HOSIERY MILLS,
INC.

The foregoing motion is approved and acquiesced in by counsel for Commisisoner of Internal Revenue, respondent in TC No. 24,571 and petitioner in TC No. 24,640.

(Signed) CHARLES W. DAVIS,
Chief Counsel, Bureau of Internal Revenue.

DESIGNATION FOR TRANSCRIPT OF RECORD.

Filed August 15, 1952.

The Tax Court of the United States.

Grenada Industries, Inc., Petitioner,
vs. T. C. No. 24571
Commissioner of Internal Revenue, Respondent.

To Clerk of the Tax Court of the United States:

You will please prepare for review in the above entitled case certified copies of the following documents and records of proceedings before The Tax Court of the United States and transmit the same to the Clerk of the United States Court of Appeals for the Fifth Circuit within the time provided for settlement and transmission of such record as enlarged by order or orders of the Court:

1. Docket entries of proceedings before The Tax Court of the United States in this proceeding, and also in proceeding of National Hosiery Mills, Inc. v. Commissioner, T. C. No. 24640.

2. Pleadings before The Tax Court, including exhibits attached and made part thereof in this proceeding, and also in proceeding of National Hosiery Mills, Inc. v. Commissioner, T. C. No. 24640.

3. Findings of fact, opinion and decisions of The Tax Court promulgated and entered in this proceeding, as well as in the proceeding of National Hosiery Mills, Inc. v. Commissioner, T. C. No. 24640.

4. Stenographic report of evidence—three volumes—introduced and filed in the proceedings, as well as in the proceedings of National Hosiery Mills, Inc. v. Commissioner, T. C. No. 24640.

5. Request of parties, if any, for corrections of stenographic report of evidence.

6. Petition for review and assignments of error in this proceeding.

7. Motion of parties for consolidation; transmission of testimony as part of certified record; and transmission of original exhibits.

8. Order of Court entered on above motion.

9. Original exhibits to be transmitted but not as a part of certified record, are designated as follows:

(a) Joint Exhibits A1, B2, C3, 4D, 5E, 6F, 7G, 8H, 9I, 10J, 11K, 12L, 13M, 14N, 35-O, 36P, 38Q, 39R, 41V, 42W, 43X, 44Y, 45Z, 46AA, 47BB, 48CC, 49DD, 50EE, and 51FF.

(b) Petitioner's Exhibits 15 to 34, inclusive; 37 and 40.

(c) Respondent's Exhibits S, T and U.

10. This designation.

ROBERT A. LITTLETON,
(Robert A. Littleton),
Attorney for Petitioner,

1021 Tower Building,
Washington, D. C.

GRENADA INDUSTRIES, INC.

Service of foregoing designation, together with receipt of copy, is acknowledged this the 15th day of August, 1952.

(Signed) CHARLES W. DAVIS, CAR.
Chief Counsel, Bureau of Internal Revenue, Attorney for Respondent.

CERTIFICATE.

The Tax Court of the United States, Washington.

Grenada Industries, Inc., Petitioner,
v. Docket No. 24571
Commissioner of Internal Revenue, Respondent.

I, VICTOR S. MERSCH, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 554, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 12th day of September, 1952.

VICTOR S. MERSCH,
Clerk, The Tax Court of the
United States.

(Seal)

[fol. 500] That thereafter the following proceedings were had in said cause in the United States Court of Appeals for the Fifth Circuit, viz:

ARGUMENT AND SUBMISSION

Extract from the Minutes of March 2, 1953

No. 14272

GRENADA INDUSTRIES, INC.,

versus

COMMISSIONER OF INTERNAL REVENUE

On this day this cause was called, and after argument by Arthur L. Gilliom, Esq., for petitioner, and Miss Maryhelen Wigle, Special Assistant to the Attorney General, for respondent, was submitted to the Court.

[fol. 501] OPINION OF THE COURT—Filed March 26, 1953

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 14272

GRENADA INDUSTRIES, INC., Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent

Petition for Review of Decision of The Tax Court of the United States (District of Mississippi)

(March 26, 1953)

Before Hutcheson, Chief Judge, and Holmes and Rives, Circuit Judges

HUTCHESON, Chief Judge:

This proceeding was brought by the petitioner, Grenada Industries, Inc., for the review of a decision[1] of the Tax

[1] 17 T. C. 231.

Court of the United States under the provisions of sections 1141 and 1142 of the Internal Revenue Code (Title 26, U. S. C. A., sections 1141-1142). The decision under review de-
[fol. 502] termined deficiencies in income, declared value excess profits, and excess-profits taxes in amounts aggregating $136,383.53 for the fiscal years of the petitioner ended March 31, 1941, March 31, 1942, March 31, 1943, and March 31, 1944. All of these deficiencies resulted from the Tax Court's approval of the respondent Commissioner's action, under Sec. 45 I. R. C.,[2] in allocating to the petitioner, and consolidating with its income portions of the income of Grenada Hosiery Mills (a partnership, found by the Tax Court as "valid" and entitled to recognition as a "separate entity"). The petitioner, Grenada Industries, Inc., is here challenging all of these deficiencies.

Urging upon us that the contract of June 24, 1940, between "Hosiery" and "Grenada" is absolutely controlling here and must be given effect as written, petitioner insists that the Tax Court erred in failing to give to the contract the interpretation and effect given it by the parties and contended for there and here by petitioner. Particularly it urges upon us that the Tax Court erred in holding that Sec. 45 I. R. C. authorized the Commissioner to allocate to the petitioner as its income portions of the income which under the contract of June 24, 1940, the parties to it had allocated to "Hosiery."

---

[2] Sec. 45 of the Internal Revenue Code (Title 26 U. S. C. A., Sec. 45) reads as follows:

"Sec. 45. Allocation of income and deductions. In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses."

The Commissioner in effect accepts the Tax Court's

decision in the respects in which it was adverse to him. [fol. 503] Agreeing that the only question for our decision is whether the Tax Court erred in allocating to petitioner, under Sec. 45 I. R. C., "a portion of the purported income" of the partnership Hosiery, he insists that its findings of fact find full support in the record and that its decision based thereon is in full accord with the applicable law.

A careful examination of the Tax Court's thorough and painstaking analysis of the facts and its equally thorough discussion and exposition of the meaning and effect of Sec. 45, as applied to the facts of this case, convinces us that the facts have been correctly apprehended and stated and the law as correctly applied to them. Indeed, we find ourselves in such complete agreement with its excellent opinion that we content ourselves with saying so. Without, therefore, attempting to add anything to or take anything from its clear and convincing discussion and decision of the question posed, we note our agreement with the opinion of the Tax Court and affirm its decision upon the grounds and for the reasons stated by it.

Affirmed.

[fol. 504] JUDGMENT

Extract from the Minutes of March 26, 1953

No. 14272

GRENADA INDUSTRIES, INC.,

versus

COMMISSIONER OF INTERNAL REVENUE

This cause came on to be heard on the petition of Grenada Industries, Inc., for a review of a decision of the Tax Court of the United States, and was argued by counsel;

On consideration whereof, it is now here ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby, affirmed.

[fol. 505] Clerk's Certificate to foregoing transcript omitted in printing.

INDEX.

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statute and regulation involved	3
Statement	3
Specifications of error to be urged	10
Reasons for granting the writ	11
Conclusion	19
Appendix	21

Cases Cited.

Advance Machinery Exchange, Inc., v. Commissioner of Internal Revenue, 196 F. (2d) 1006 15

Commissioner of Internal Revenue v. Chelsea Products, Inc., 197 F. (2d) 620 (1952) 14, 15

Helvering, Commissioner of Internal Revenue, v. Taylor, 293 U. S. 507-516, 79 L. ed. 623.....17, 18, 19

National Carbide Corp. v. Commissioner, 336 U. S. 422, 93 L. Ed. 779 .....15, 16

Rupple v. Kuhl, Collector, 177 F. (2d) 823..... 19

Statutes Cited.

Section 45 of the Internal Revenue Code (Title 26, U. S. C. A., section 45) 2, 3, 4, 9, 10, 11, 13, 15, 18

Sections 1141-1142 of the Internal Revenue Code (Title 26, U. S. C., sections 1141-1142)..... 2

Title 26, U. S. C., section 1141 (a) 2

Title 28, U. S. C., section 1254 (1) 2

Miscellaneous Cited.

House Report No. 2, 70th Cong., 1st Sess., p. 16..... 13
Senate Report No. 960, 70th Cong., 1st Sess., p. 24.... 13
Treasury Regulation 103, sec. 19.45-1 (b) and (c)..... 11
Treasury Regulation 111, sec.
29.45-1 (b) 2, 6, 10, 12, 13, 14, 16
Treasury Regulation 111, sec. 29.45-1 (c)..... 12

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1952.

No. .....

GRENADA INDUSTRIES, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Court of Appeals for the Fifth Circuit.

Grenada Industries, Inc., a corporation organized and existing under the laws of the State of Mississippi, petitions the Supreme Court of the United States to issue a writ of certiorari to the United States Court of Appeals for the Fifth Circuit to review its judgment entered in the above-entitled case on March 26, 1953.

OPINIONS BELOW.

The opinion of the Tax Court of the United States (R. 173) is reported in 17 T. C. 231. The opinion of the United States Court of Appeals for the Fifth Circuit (R. 500) is reported in 202 F. (2d) 873.

JURISDICTION.

The proceeding before the Court of Appeals in which said judgment was entered was brought under the provisions of sections 1141-1142 of the Internal Revenue Code

(Title 26, U. S. C., sections 1141-1142) for the review of a decision of the Tax Court of the United States. The jurisdiction of the Supreme Court is invoked under Title 28, U. S. C., sec. 1254 (1), and Title 26, U. S. C., sec. 1141 (a).

QUESTIONS PRESENTED.

1. Whether section 45 of the Internal Revenue Code may properly be construed as authorizing either the Commissioner of Internal Revenue, or the Tax Court of the United States in a redetermination proceeding, to determine what, if any, part of the ascertained net income of an organization, received by it from its conduct of its separate trade or business in a separate division of an industry, should as a matter of the opinion of either the Commissioner or the Tax Court be allowed to the organization for its net profit or reward and to allocate and tax the overplus of its net income resulting from such determination to another organization that is controlled by the same interests and engaged in the conduct of a related business in another division of the same industry, particularly in a situation where neither of such organizations conducts its business as agent of the other and where each earns its separate income on a contractual basis that comports with the "arm's length" standard prescribed in Treasury Regulation 111, sec. 29.45-1 (b).

2. Whether in a redetermination proceeding before the Tax Court, where the tax deficiency in question rests on an allocation made by the Commissioner of Internal Revenue, the taxpayer is entitled to have the deficiency set aside upon proof that the basis on which the Commissioner made the allocation was arbitrary, or whether the taxpayer must go further and prove that no other allocation on any other basis could lawfully be made.

STATUTE AND REGULATION INVOLVED.

Section 45 of the Internal Revenue Code (Title 26, U. S. C. A., Sec. 45) reads as follows:

> "Sec. 45. Allocation of income and deductions. In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses."

Section 29.45-1 (b), (c) of Treasury Regulations 111 is printed in the Appendix, infra.

STATEMENT.

Large income and excess-profits tax deficiencies were determined by the Commissioner of Internal Revenue against the petitioner for its fiscal years ended March 31, 1941, 1942, 1943, and 1944. As redetermined by the Tax Court, in a redetermination proceeding brought by the petitioner, the deficiencies for the period aggregate the sum of $136,383.53 (R. 187, 188), all of which is here in issue. The Tax Court's decision was affirmed by the Court below by final judgment (R. 502). These tax deficiencies are based wholly on the Commissioner's addition to the net income of the petitioner for each of the years involved of a portion of "Net Income as Adjusted" (R. 170) of a partnership known as Grenada Hosiery Mills (referred to as "Hosiery"), in amounts aggregating $167,315.94 for the

period (R. 171). These amounts of Hosiery's net income were allocated by the Commissioner to the petitioner under claimed authority of section 45 of the Internal Revenue Code. The Tax Court interpreted section 45 as authorizing the allocation of these amounts from Hosiery to the petitioner and approved "an allocation" of the amounts, but on a basis of its own choosing wholly different from the basis on which the Commissioner had allocated the amounts, as will presently appear.

The lower court, after stating that the only question for its decision was "whether the Tax Court erred in allocating to the petitioner under Sec. 45, I. R. C., 'a portion of the purported income' of the partnership Hosiery," adopted the Tax Court's opinion in toto without "attempting to add anything to or take anything from" it (R. 502).

The allocation thus referred to by the lower court is the one mentioned in the following passage from the opinion of the Tax Court (R. 185), to-wit:

> "We approve an allocation of Hosiery's gross income to the extent that such gross income in fact exceeded the fair value of the services rendered by Hosiery to Industries (petitioner), and we think that, in essence, respondent did substantially that here (after making an allowance of a 10 per cent return on the partners' capital)."

"Hosiery," referred to in the opinions, and the petitioner were by the Tax Court found and held to be two of several "separately existing and functioning organizations, trades, or businesses . . . owned or controlled directly or indirectly by the same interests"[1] (R. 172). The Tax Court further found and held that Hosiery was a "valid partnership" that played "real parts in the hosiery business" and

---

1 For the purpose of this petition it is assumed that the petitioner and Hosiery were controlled by the same interests within the meaning of section 45.

"rendered valuable services" (R. 173), so that it was entitled to recognition as a "separate entity" (R. 180).

The "allowance of a 10 per cent return on the partners' capital" to which the Tax Court's opinion refers was the basis chosen by the Commissioner for allowing to Hosiery a portion of its "Net Income as Adjusted" and for allocating portions thereof to the petitioner (R. 170-171). It appears in the revenue agent's report (Petitioner's Exhibit 16), in accordance with which the Commissioner made the allocations (R. 172), that this basis was chosen by the Commissioner because in his opinion 10% "might reasonably be earned upon the capital which was invested in the partnership." The agent's report further states that of Hosiery's "Net income to be allocated . . .," the amounts allocated to the petitioner were "Excessive profits" of Hosiery.

Hosiery's total "Net Income as Adjusted" for the period of its own fiscal years ended June 30, 1941, through 1944 was $212,909.30 (R. 170). In its trade and business, the services furnished, not invested capital, was the important income producing factor (R. 153). For that reason Hosiery's invested capital was only $4,286.25 so that the Commissioner's 10% allowance thereon would yield only $428.63 per annum as a net profit for Hosiery (R. 171). As conformed by the Commissioner to the petitioner's fiscal years, Hosiery's total net income for the four-year period was $195,840.21, out of which total sum the Commissioner allowed Hosiery a net profit of only $428.63 a year, or $1,714.52 for the period. In terms of percentages more than 99% of Hosiery's total net income was allocated to the petitioner and others, and less than 1% was allowed to Hosiery for its net profit. More than 85% thereof was allocated by the Commissioner to the petitioner alone in amounts as follows: $62,068.57 for petitioner's fiscal year ended March 31, 1941; $29,164.11 for 1942; $30,189.53 for 1943; and $45,893.73 for 1944, aggregating in all $167,315.94 (R. 171).

Except for the addition of said allocated amounts, the petitioner's net income for each year was ascertained and adjusted by the Commissioner from its returns, and books and records of account. At no stage did the Commissioner distribute, apportion, or allocate a single item of "gross income, deductions, credits, or allowances" (Sec. 45) between Hosiery and the petitioner. The only items which he allocated between Hosiery and the petitioner consisted of the aforementioned amounts of Hosiery's ascertained net income (R. 99, 107, 113, 121).

Neither Hosiery's, nor the petitioner's, separate income was earned on the Commissioner's basis of a return on invested capital or on the Tax Court's basis of "fair charges" for services. Each earned its income, instead, in a separate and distinct phase, or phases, of a hosiery enterprise assigned to it in a written contract, dated June 24, 1940 (Articles I and II, R. 155), and on a basis which was customary in the hosiery industry (R. 161, 247, 461) and which comported with the "arm's length" standard prescribed in section 29.45-1 (b) of Treasury Regulations 111 (Appendix, infra).

The contract assigned to the petitioner the phase of manufacturing the hosiery in the unfinished gray stage, which is a recognized separate phase of the hosiery industry, and there is a market for hosiery in its unfinished gray stage (R. 135). Approximately 200 other organizations make only unfinished gray hosiery and sell their entire outputs in that stage (R. 247), and make their profits exclusively in that manner (R. 461). The contract assigned the finishing, merchandising and selling phases of the enterprise to Hosiery, each of which also is a recognized separate phase of the hosiery industry, and many engage in only one, or in a combination thereof (R. 135). The contract was for a term of five years from July 1, 1940, to June 30, 1945, and covered all of petitioner's tax years here involved. It left both parties thereto com-

pletely independent of each other in the performance of their respective assignments, and did not place either under the control or direction of the other in any manner or for any purpose (R. 154-159).

The petitioner itself never engaged in the finishing, merchandising, or selling phases of the hosiery industry and never was equipped to do so (R. 140-141). The role in the enterprise which Hosiery performed from and after July 1, 1940, had theretofore been performed by Grenada Knitting Mills, Inc., from the start of the enterprise in 1938 (R. 146-147). Each of the three organizations was expressly organized for the single purpose of performing one or more of the separate phases of the enterprise under the leadership and general guidance of L. L. Goodman, J. A. Goodman and Henry V. Kobin (R. 229, 234, 243). These men had long and successful experience in all phases of the hosiery industry, and were especially expert in the merchandising and selling phases (R. 136). The ownership of the majority of the shares of the petitioner corporation, also a majority of the partnership interests in Hosiery, was diffused among members of the families of these men, either as legal owners or as beneficial owners under trusts which they had from time to time created (R. 144-146, 150-151). The Goodmans and Kobin were members of a policy-making committee of Hosiery (R. 152) and were employed by it as experts (R. 162), and it paid them substantial amounts for the services rendered by them to it (R. 163). The petitioner was under active management of I. E. Solar, who was also its president during the years involved (R. 345). The Goodmans served on petitioner's executive committee.

All settlements made between the petitioner and Hosiery were upon invoices from the petitioner to Hosiery for amounts computed at the fair market price for gray hosiery applied to the quantities of gray hosiery specified in the invoices, plus reimbursement for any finishing costs

that may have been billed to and paid by the petitioner[1] (R. 160-161). Under this joint enterprise the petitioner actually enjoyed a steadier and better market for its output of gray hosiery than others did who sold their output outright on the gray hosiery market (R. 162). Any net income derived by Hosiery from its separate trade or business in the performance of its assigned phases of the enterprise had to come, and did come, out of the gross receipts of the enterprise, after payment by it of petitioner's invoices and all finishing, merchandising and selling costs and expenses which fell on Hosiery under the terms of the contract (Articles IV-VI, R. 155-159).

The Tax Court approved "an allocation" of the same amounts which the Commissioner had allocated to the petitioner from Hosiery's net income but on a different basis chosen by it, viz., the basis of allowing to Hosiery "fair charges" measured by the "fair value" of the services rendered by it in the promotion of the enterprise (R. 182, 185). The Tax Court's said basis is completely different from the 10% return basis which the Commissioner had used, and both are fundamentally and completely different from the industry basis which the petitioner and Hosiery embodied in their contract and settlements and on which they earned and received their respective incomes in their respective trades and businesses while jointly promoting the said hosiery enterprise. In their settlements under the contract the parties always used the "fair market price" basis and the petitioner never got less than amounts determined by applying fair market price to the unfinished gray hosiery produced by it (R. 161, 355). That is the same basis on which all gray hosiery manufacturers (more than 200 in number) customarily derive their incomes and make their profits (R. 247, 461).

---

1 The same basis and method of settlement had been used by the petitioner and Hosiery's predecessor as was used by the petitioner and Hosiery (R. 147).

There is no contract or obligation shown in the evidence for payment to Hosiery of "fair charges." The contract between them expressly provided, in Article VI (R. 157), that Hosiery should not receive any compensation except under the settlement formula provided in that article.[1]

The Tax Court evolved its said basis for approving an allocation of said amounts to the petitioner from its expressed view (R. 182) that because the petitioner did not actually sell its unfinished gray product to Hosiery and kept the legal title to the hosiery until it was sold in finished form to the trade, "It (petitioner) was entitled to receive the full price paid for its finished product minus such fair charges as may have been incurred" for services furnished in completing the manufacturing process and selling the finished hosiery to the trade (R. 182). Having made a finding that the services of Hosiery, although "valuable" (R. 180), were not worth more than the salaries and wages paid by Hosiery in rendering the services (R. 173), the Tax Court concluded that the amounts allocated to the petitioner were in excess of the value of the services and are properly allocable under section 45 to the petitioner as income to which it is "entitled" (R. 185).

---

1 The formula provided for the sharing by the parties in the gross profits of the enterprise, after payment of certain designated costs, in such proportions as were attributable to the respective efficiencies of the parties in performing their respective parts, of the enterprise, to be determined and computed by agreement or by arbitration (Articles VI-VIII, R. 156-158). The reason for the formula was that it was contemplated that before the end of the five-year term of the contract the petitioner might itself wish to install finishing facilities (Article IX reserved that right), in which case it was to receive more under the formula than fair market price for gray hosiery plus reimbursement of finishing costs (R. 352-354). The petitioner did not install finishing facilities during the period involved, and in that circumstance the parties continued to use the settlement method which had been in use from the start of the enterprise, under which the petitioner was paid the fair market price applied to quantities of gray hosiery invoiced, plus reimbursement for finishing costs (R. 147, 161, 348-349).

SPECIFICATIONS OF ERROR TO BE URGED.

The United States Court of Appeals for the Fifth Circuit erred:

1. In approving the Tax Court's interpretation of Section 45 of the Internal Revenue Code to the effect that it authorizes the Commissioner of Internal Revenue, or the Tax Court, to allocate and tax ascertained net income of one controlled organization to another controlled organization, and in approving the application of the section which the Tax Court made under that interpretation in the instant case, where the petitioner and Hosiery concededly had earned separate incomes that could be ascertained from their books.

2. In holding with the Tax Court that in a redetermination proceeding before the Tax Court, where the tax deficiency in question rests on an allocation made by the Commissioner, the taxpayer must prove not only that the allocation was made on an arbitrary basis, but also that no allocation on any basis can lawfully be made, in order to be entitled to have the tax deficiency set aside, and in holding that this petitioner had not discharged its burden of proof.

3. In failing to give recognition and effect to the well-established and basic legal right of the petitioner as a corporation and as a taxpayer to restrict its facilities and business, from the beginning and at all times thereafter, to the separate phase of the hosiery industry in which hosiery is manufactured in the unfinished gray stage, and to agree in the contract here involved to perform only the said phase of the joint enterprise covered by the contract and to limit its right to income thereunder on the basis carried in effect by the settlements made in consonance with the "arm's length" basis on which uncon-

trolled gray hosiery manufacturers customarily derive their incomes and profits, without the petitioner becoming liable for taxes on income which Hosiery derived under the contract from its performance in its separate trade and business of the other separate phases of the joint enterprises through means of facilities supplied and/or engaged by it.

4. In holding that the allocations in question are reasonable and necessary in order to reflect petitioner's true income and to prevent evasion of taxes.

5. In affirming the decision of the Tax Court.

REASONS FOR GRANTING THE WRIT.

1.

Clearly, of immediate and wide importance and concern in the administration of the Internal Revenue Code is the question decided by the lower Court and presented here of whether section 45 of the Code was intended by Congress to authorize the Commissioner of Internal Revenue to determine an amount which in his opinion constitutes a sufficient annual net profit for one of two or more controlled organizations, engaged in related separate trades or businesses, and to allocate and tax the resulting overplus of its ascertained net income to another or others.

That question is of immediate and wide importance, far beyond the particular case and the particular parties here involved, for the reason that it is a well-known common practice in the conduct of business throughout the United States for business interests to conduct related trades and businesses through separate organizations controlled by the same interests, and it is obvious that all such organizations, as well as the Government, are directly and immediately affected in important ways by the interpretation

given to section 45 of the Code by the Court below. The long-established legal right thus to conduct related trades or businesses without one controlled organization becoming liable for taxes on the income of another, absent a principal-agent relationship between them, has always been recognized in the Treasury Regulations ever since section 45 was enacted, provided only that the "arm's length" standard furnished in the Regulations is observed in practice. See Treasury Regulations 111, sec. 29.45-1 (b) and (c); also Treasury Regulations 103, sec. 19.45-1 (b) and (c). Many taxpayers, including the petitioner, have relied on that standard.

Under the interpretation given to section 45 by the Court below, this right may no longer be exercised with any assurance to taxpayers that the "arm's length" standard provided in the Treasury Regulations will be observed by the Commissioner when he examines their tax returns or by the courts which review his determinations. Under that interpretation the Commissioner or the Tax Court may completely disregard the arm's length standard prescribed in the Treasury Regulations and may distribute and tax the income of one controlled organization to another or others on some different basis, or bases, invented for each particular case.[1]

The lower court's interpretation and application of section 45 appears erroneous in view of the language of the section and of the statements on the scope and purpose of the section contained in the reports of the House and Senate Committees and in Treasury Regulations 111, sec. 29.45-1 (b). The language used by Congress in the sec-

---

1 The Commissioner invented and used a hundred per cent (100%) return on the $1,000 invested capital of Abar Process Company as a basis for the purpose of allocating a portion of the resulting overplus of its net income to the petitioner, and with respect to Hosiery he invented a ten per cent (10%) return as a basis for the same purpose (R. 171). The allocations from Abar Process Company's income were disapproved by the Tax Court (R. 178). And in the instant case the Tax Court invented the "fair charges" basis for services rendered as the basis for "an allocation."

tion only says that the Commissioner may allocate "gross income, deductions, credits, or allowances," and those items only when "necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades, or businesses" (Title 26, U. S. C., sec. 45). The Committee reports, in virtually identical language, state that the purpose of section 45 is "to prevent evasion (by the shifting of profits, the making of fictitious sale, and other methods frequently adopted for the purpose of 'milking'), and in order clearly to reflect their true tax liability" (House Rep. No. 2, 70th Cong., 1st Sess., p. 16. Senate Rep. No. 960, 70th Cong., 1st Sess., p. 24).

Treasury Regulations 111, sec. 29.45-1 (b) contains the following statement of the purpose of section 45:

> "The purpose of section 45 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true net income from the property and business of a controlled taxpayer."
>
> . . . . . .
>
> "The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer."
>
> . . . . . .
>
> "It is not intended (except in the case of the computation of consolidated net income under a consolidated return) to effect in any case such a distribution, apportionment, or allocation of gross income, deductions, credits, or allowances, or any item of gross income, deductions, credits, or allowances, as would produce a result equivalent to a computation of consolidated net income under section 141."

There is no language in section 45 or in the Committee reports or in the Treasury Regulations to the effect that

the Commissioner, or the Tax Court, is empowered to determine what in his or its opinion constitutes a sufficient annual net profit, or reward, for any controlled organization and to allocate and tax the resulting over-plus of its ascertained net income to another or others, as was done by him and approved by the lower Court in the instant case. If that is permissible under section 45 in the instant case then it will be permissible in numerous other cases of other taxpayers who also have relied on the "arm's length" standard prescribed in the Treasury Regulations. Hence, the immediate and wide importance of this question in the administration of the Internal Revenue Code.

2.

There is a direct conflict between the instant decision of the Court of Appeals below and the decision of the United States Court of Appeals for the Third Circuit in **Commissioner of Internal Revenue v. Chelsea Products, Inc.**, 197 F. (2d) 620 (1952), with respect to the section 45 question here presented. In that case the Commissioner recognized four controlled corporations as separate entities engaged in related businesses and then, under claimed authority of section 45, he determined that the whole of the ascertained net incomes of three of them, which were engaged in the sale of products manufactured by the fourth, should be allocated to the manufacturing corporation and combined with its net income for tax purposes. There, the Court carefully reviewed the language of section 45 in light of its legislative history and of the relevant reports of the House and Senate Committees, and in light also of the interpretation of the section in Treasury Regulation 111, 29.45-1 (b); and then said:

> "Section 45 grants to the Commissioner power to allocate 'gross income, deductions, credits, or allowances.' There is no mention of authority to disregard

completely the corporate entity by combining the net income of controlled corporations. The plain language of section 45 must prevail."

In that case the Court held, the same as the Tax Court had held[1], that Section 45 did not authorize the Commissioner to make said net income allocations. There, 100% of the net incomes derived by three separate organizations in related businesses was allocated and taxed to a fourth organization. Here, 99-plus% of Hosiery's "Net Income as Adjusted" was allocated and taxed to the petitioner and two others. The pittance of $428.63 allowed by the Commissioner to Hosiery for its annual net profit obviously does not distinguish the instant case from the **Chelsea Products** case.

Also in conflict with the construction given to said Section 45 in the **Chelsea Products** case is the construction which the United States Court of Appeals for the Second Circuit gave to said section in **Advance Machinery Exchange, Inc., v. Commissioner of Internal Revenue**, 196 F. (2d) 1006. In that case the Commissioner allocated the whole income of a single business to the organization which conducted it but in which several claimed to have had a part. The Tax Court found it was impossible to determine where the activities of any of the others began and ended. The Tax Court held that Sec. 22 (a), not Sec. 45, applied (8 T. C. M. 84). The Court of Appeals, however, went along with the Commissioner's contention that his action was authorized by Section 45, and approved the allocations under that section. That decision is referred to in a footnote to the opinion in the **Chelsea Products** case, where the following is said:

---

1 The Tax Court, by a majority of its judges, held that the doctrine of **National Carbide Corp. v. Commissioner**, 336 U. S. 422, 93 L. Ed. 779, applied, and that section 45 of the Code did not authorize the allocation of the net incomes of three of the controlled organizations to the fourth. 16 T. C. 840, 851. Five judges, of whom the author of the instant opinion was one, joined in a dissent (p. 853) upon reasoning similar to the reasoning employed in the instant opinion.

"In affirming the decision of the Tax Court, the Court of Appeals for the Second Circuit relied on Sec. 45 rather than Sec. 22 (a). We consider the Court's observation with respect to Sec. 45 to be essentially dicta, for, since the Tax Court had determined that there was but one taxable entity, all the net income was necessarily taxable to taxpayer under Sec. 22 (a)."

It is clear that the conflicting interpretations of Section 45 in the foregoing cases will cause great and wide-spread confusion and uncertainty among controlled taxpayers throughout the country, and will be conducive to much litigation by many taxpayers in all parts of the nation. Under the interpretation of Section 45, which the lower court approved, no controlled taxpayer can safely conduct business for the reason that said interpretation completely disregards the "arm's length" standard prescribed in Section 29.45-1 (b) of Treasury Regulations 111 and extends the scope and purpose of Section 45 far beyond the limits stated in said Treasury Regulation and without any known limits or guides of its own.

3.

The decision in the instant case is in direct conflict with the doctrine of **National Carbide Corporation v. Commissioner**, 336 U. S. 422, 93 L. Ed. 779, that where a controlled organization conducts a business in a separate division of a general business, not as agent for another, then the whole income from such separate business is taxable to it as the earner thereof.

In the instant case it is clear that the written contract between the petitioner and Hosiery (R. 154-159) did not constitute Hosiery the agent of the petitioner for the purpose of conducting the finishing, merchandising and selling phases of the joint enterprise. Whatever net income Hosiery earned under the contract in the phases of the enterprise

assigned to it was wholly taxable to its partners under the doctrine of the **National Carbide Corp.** case—not only the $1,714.52 which the Commissioner allowed as a net profit out of the partnership's total ascertained net income of $195,840.21. By approving this action of the Commissioner, the decision below is in clear conflict with said doctrine as established by this Court in the above case.

4.

The question presented concerning the taxpayer's burden of proof in a redetermination proceeding before the Tax Court, where the tax deficiency rests on an allocation made by the Commissioner, is likewise of wide public importance.

Moreover, the decision of the court below on this point is in conflict with **Helvering, Commissioner of Internal Revenue, v. Taylor,** 293 U. S. 507-516, 79 L. ed. 623. There this Court expressly decided a similar question concerning burden of proof in a redetermination proceeding before the Board of Tax Appeals and held that the taxpayer is entitled to have a tax deficiency set aside upon proof which stops with a showing that an apportionment is arbitrary on the basis used by the Commissioner in making it.

In that case the tax deficiency rested on an apportionment made by the Commissioner of the lump acquisition cost of common and preferred stock by apportioning a part thereof as representing his determination of the acquisition cost of the preferred stock. The basis and method used by the Commissioner in making the apportionment were found to be arbitrary on evidence adduced by the taxpayer. The question was whether the taxpayer was entitled to have the deficiency set aside upon proof which stopped with the showing that the basis and method used by the Commissioner were arbitrary. This Court held that in a redetermination proceeding the taxpayer need go no further with his proof than to show that the Commission-

er's determination is arbitrary and excessive, in order to be entitled to have the tax deficiency set aside. The Court said in that case:

> "We find nothing in the statutes, the rules of the board or our decisions that gives any support to the idea that the commissioner's determination, shown to be without rational foundation and excessive, will be enforced unless the taxpayer proves he owes nothing or, if liable at all, shows the correct amount.
>
> " . . . where, as in this case, the taxpayer's evidence shows the commissioner's determination to be arbitrary and excessive it may not reasonably be held that he is bound to pay a tax that confessedly he does not owe, unless his evidence was sufficient also to establish the correct amount that lawfully might be charged against him. On the facts shown by the taxpayer in this case, the board should have held the apportionment arbitrary and the commissioner's determination invalid."

The decision of the Court below is clearly in conflict with the principle established in **Helvering v. Taylor**, supra, that in a redetermination proceeding a taxpayer is entitled to have a tax deficiency set aside upon proof that an arbitrary basis and method was used in making an apportionment on which the deficiency is based, unless the taxpayer's evidence is "sufficient also to establish the correct amount that lawfully might be charged against it." The Commissioner's basis of a 10% return on capital is so patently arbitrary that neither the Tax Court nor the Court below attempted to justify it.

Moreover, there is no basis shown in the evidence on which any part of Hosiery's "Net Income As Adjusted" (R. 170) can lawfully be allocated to the petitioner, because to do so is not authorized on any basis by Section 45, properly interpreted and applied. Neither does the

Commissioner's mislabeling of the allocations as "gross income" allocations (R. 100), nor the Tax Court's characterization of them as being "in essence" allocations of "gross income" (R. 185), bring the allocations in question within the authority of Section 45 on any conceivable valid basis. The "fair charges" basis used by the Tax Court for its approval of the amounts of the allocations in question is obviously also wholly unwarranted and arbitrary under all of the evidence in the record.

The lower Court's refusal to set aside the tax deficiencies, which are based exclusively on said arbitrary allocations, is in plain conflict with the principle of **Helvering v. Taylor**, supra.

5.

The instant case was erroneously decided by the court below. The decision is erroneous not only because of the aforementioned erroneous interpretation of Section 45 under which net income of Hosiery was allocated and taxed to the petitioner, but also because of the failure of the court below to give recognition and effect to the basic right of the petitioner to limit its participation in the work and income of the joint enterprise as was done in the contract of June 24, 1940. The legal right of the petitioner as a corporation and as a taxpayer thus to limit its activities and income is basic, and having received its income on an "arm's length" basis as contemplated by Section 29.45-1 (b) of Treasury Regulations 111, it cannot lawfully be made to pay taxes on the income derived by Hosiery. The contract constituted the petitioner and Hosiery as joint enterprisers. A joint venture is accorded the same tax treatment as a partnership, and the petitioner as a joint venturer could, therefore, not be taxed on income belonging to the other joint venturer (Hosiery) under the contract. **Rupple v. Kuhl, Collector of Internal Revenue**, 7 Cir., 177 F. (2d) 823, 826.

CONCLUSION.

The petitioner respectfully says that the writ of certiorari should be granted for the reasons above given concerning the immediate and wide importance of the questions presented and concerning conflicts in decisions. Additional points and reasons appear in the Specification of Errors, ante, which concern primarily this particular case.

Respectfully submitted,

ROBERT A. LITTLETON,
Suite 1021 Tower Building,
Washington 5, D. C.,
ARTHUR L. GILLIOM,
ELBERT R. GILLIOM,
Suite 1344 Consolidated Building,
Indianapolis 4, Indiana,
Attorneys for Petitioner.

Of Counsel:
SAMUEL J. MANTEL,
Of Indianapolis, Indiana.

APPENDIX.

Section 29.45-1 (b), (c) of Treasury Regulations 111 reads as follows:

"(b) **Scope and Purpose.**—The purpose of section 45 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true net income from the property and business of a controlled taxpayer. The interests controlling a group of controlled taxpayers are assumed to have complete power to cause each controlled taxpayer so to conduct its affairs that its transactions and accounting records truly reflect the net income from the property and business of each of the controlled taxpayers. If, however, this has not been done, and the taxable net incomes are thereby understated, the statute contemplates that the Commissioner shall intervene, and, by making such distributions, apportionments, or allocations as he may deem necessary of gross income, deductions, credits, or allowances, or of any item or element affecting net income, between or among the controlled taxpayers constituting the group, shall determine the true net income of each controlled taxpayer. The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arms-length with another uncontrolled taxpayer.

"Section 45 and this section apply to the case of any controlled taxpayer, whether such taxpayer makes a separate or a consolidated return. If a controlled taxpayer makes a separate return, the determination is of its true separate net income. If a controlled taxpayer is a party to a consolidated return, the true consolidated net income of the affiliated group and the true separate net income of the controlled

taxpayer are determined consistently with the principles of a consolidated return.

"Section 45 grants no right to a controlled taxpayer to apply its provisions at will, nor does it grant any right to compel the Commissioner to apply such provisions. It is not intended (except in the case of the computation of consolidated net income under a consolidated return) to effect in any case such a distribution, apportionment, or allocation of gross income, deductions, credits, or allowances, or any item of gross income, deductions, credits, or allowances as would produce a result equivalent to a computation of consolidated net income under section 141.

"(c) **Application.**—Transactions between one controlled taxpayer and another will be subjected to special scrutiny to ascertain whether the common control is being used to reduce, avoid or escape taxes. In determining the true net income of a controlled taxpayer, the Commissioner is not restricted to the case of improper accounting, to the case of a fraudulent, colorable, or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income, deductions, credits or allowances. The authority to determine true net income extends to any case in which either by inadvertence or design the taxable net income, in whole or in part, of a controlled taxpayer, is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arms-length with another uncontrolled taxpayer (Reg. 111, Sec. 29.45-1)."

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	1
Statute and regulations involved	2
Statement	2
Argument	12
Conclusion	17
Appendix	18

CITATIONS

Cases:	
Advance Machinery Exch. v. *Commissioner*, 196 F. 2d 1006, certiorari denied, 344 U. S. 835	12, 16
Asiatic Petroleum Co. v. *Commissioner*, 79 F. 2d 234, certiorari denied, 296 U. S. 645, rehearing denied, 296 U. S. 664	12
Central Cuba Sugar Co. v. *Commissioner*, 198 F. 2d 214, certiorari denied, 344 U. S. 874	13
Commissioner v. *Chelsea Products*, 197 F. 2d 620	12, 13, 15, 16
G. U. R. Co. v. *Commissioner*, 117 F. 2d 187	12
Helvering v. *Taylor*, 293 U. S. 507	16
National Carbide Corp. v. *Commissioner*, 336 U. S. 422	16, 17
National Securities Corp. v. *Commissioner*, 137 F. 2d 600, certiorari denied, 320 U. S. 794	12
Statute:	
Internal Revenue Code, Sec. 45 (26 U. S. C. 1946 ed., Sec. 45)	12, 18
Miscellaneous:	
Federal Rules of Civil Procedure, Rule 52	12
Treasury Regulations 103, Sec. 19.45–1	22
Treasury Regulations 111, Sec. 29.45–1	13, 18

263294—53——1

In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 124

GRENADA INDUSTRIES, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The Tax Court opinion (R. 173–186) is reported at 17 T. C. 231. The opinion of the Court of Appeals (R. 500–502) is reported in 202 F. 2d 873.

JURISDICTION

The judgment of the Court of Appeals was entered on March 26, 1953 (R. 502). The petition for a writ of certiorari was filed on June 16, 1953. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTION PRESENTED

Whether the courts below properly approved the Commissioner's allocation to taxpayer under

Section 45 of the Internal Revenue Code of a portion of the income of a certain partnership owned or controlled by the same interests.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and Regulations are set out in the Appendix, *infra*, pp. 18–22.

STATEMENT

This case arises out of a determination by the Commissioner of Internal Revenue of deficiencies in the income and excess profits tax returns of the petitioner for the fiscal year ending March 31, 1941, through the fiscal year ending March 31, 1944. The basis for the deficiencies was the allocation by the Commissioner to the petitioner, under Section 45 of the Internal Revenue Code (Appendix, p. 18, *infra*), of portions of the income of the Grenada Hosiery Mills (hereinafter "Hosiery").[1]

[1] In the Tax Court the case of petitioner Grenada Industries, Inc., was consolidated for hearing with that of National Hosiery Mills, Inc., and the issue was whether the Commissioner had erred in allocating to these taxpayers income claimed to have been earned by Hosiery and the Abar Processing Company (R. 134). In its findings and opinion (R. 133–186), the Tax Court dealt with both cases. As to Abar, the Tax Court decided in favor of both taxpayers; as to Hosiery, the Tax Court sustained the allocation made by the Commissioner in the case of petitioner but overruled the Commissioner in the case of National Hosiery, Inc. (R. 172). The Commissioner did not appeal from that part of the Tax Court's decision which was adverse to him.

The facts, insofar as they are relevant to the issues presented by the petition, may be summarized as follows:[2]

The ladies' hosiery industry consists of a number of recognized and distinct phases, which include: (1) Manufacturing unfinished and undyed hosiery, or hosiery "in the grey," for which there is a market;[3] (2) dyeing and finishing hosiery "in the grey"; (3) developing and furnishing to manufacturing and finishing mills expert styling and merchandising specifications and ideas; (4) selling finished hosiery to the trade; (5) salvaging yarn and defective hosiery, by reclaiming yarn from waste and defective hosiery and by mending defective hosiery and selling it to the trade. Many persons and businesses engage only in one or more of these phases of the industry. (R. 135.)

In 1928 Jacob A. Goodman, Lazure L. Goodman and one Kobin organized National Hosiery Mills (hereinafter "National") which engaged in the production, dyeing, finishing and merchan-

[2] Inasmuch as petitioner concedes for the purposes of this petition that it and Hosiery were controlled by the same interests within the meaning of Section 45 (Pet. 4, n. 1), the Court is respectfully referred to the findings of the Tax Court for the underlying facts on this issue (R. 135–173). To the extent that they are necessary for an understanding of the remaining issues in the cases, they will be summarized.

[3] "Grey" is sometimes used interchangeably with "gray" and "greige.' In the "grey" stage, the hosiery has been fully knitted, looped and seamed from the raw yarn, but remains to be dyed to be finished.

dising phases of the industry. In 1937 National added a sales force. (R. 136–137.) Also in that year the Goodmans organized the petitioner, Grenada Industries, Inc., which engaged in the manufacturing of hosiery "in the grey," but lacked dyeing and finishing facilities and did not have a sales organization (R. 140–141). The capacity of National's dyeing and finishing facilities exceeded the quantity of its own "grey" goods production, and National used those facilities to process hosiery "in the grey" manufactured by other mills, including, as of 1938, substantially all of petitioner's hosiery (R. 141–143).

Grenada Hosiery Mills was organized in 1940 as a partnership under the control of the Goodmans, Kobin and one Barskin, an associate (R. 149–153). Hosiery was organized to replace a prior corporation likewise controlled by the Goodmans and Kobin, Grenada Knitting Mills, Inc., for the purpose of achieving excess profits tax advantages. (R. 149–150.) Hosiery's capital at its organization consisted solely of $4,286.25 in notes receivable contributed for or by its partners. Two of these notes, for $1,500 each, were issued by J. A. and L. L. Goodman and were given by them to trusts for their children which became partners of record in Hosiery. In May, 1941, these notes were paid by their makers in the face amount, $4,286.25, and the partners proportionally withdrew cash from

Hosiery in the total amount of $25,000. (R. 153.)

As in the case of its predecessor (Grenada Knitting Mills, Inc.), Hosiery did not at any time own, lease, or use any machinery, mill, finishing plant, or production facilities; it had no inventory nor did it at any time purchase or acquire any hosiery for resale, or otherwise; it had no sales force, but relied upon National's sales organization, which was supervised by Kobin, to sell hosiery manufactured and owned by petitioner. Hosiery's business address, as reported on its partnership tax returns, was the same as that of National. There were no persons employed by Hosiery who were not also employed by petitioner or National. (R. 153–154.)

A written agreement was entered into between Hosiery and petitioner dated June 24, 1940. Under this agreement petitioner was to manufacture hosiery "in the grey," and Hosiery was to supervise the finishing, merchandising and sale of the hosiery. The proceeds from the sales were to be distributed between petitioner and Hosiery in a proportion which was attributable to the "efficiency in the greige manufacturing" of petitioner, to the "low cost and efficient finishing as supervised" by Hosiery; to a "fair and reasonable estimate of the value" of Hosiery's merchandising plans; and to the "efficient selling as supervised" by Hosiery. (R. 154–159.)

In actual practice, petitioner manufactured hosiery "in the grey" and shipped it to National

for dyeing and finishing. National kept the hosiery finished by it for petitioner separately from its own hosiery. Except for the few large customers obtained directly by the Goodmans and Kobin, petitioner's hosiery was sold by National's sales organization and by the same salesmen who sold National's hosiery. Customers were usually invoiced by National in its own name, but some invoices were made out in Hosiery's name. Some customers made payment to Hosiery; others paid National. National deducted from the proceeds it received a charge for the use of its sales force, including an allocated portion of its sales expenses and an amount for a reasonable profit. It remitted the balance to Hosiery. Petitioner paid National's charge for finishing and dyeing, consisting of the costs of finishing and dyeing plus a reasonable profit. Notwithstanding the provisions of the June 24, 1940, agreement, petitioner "billed" Hosiery for the hosiery "in the grey," its charge consisting of an amount representing the fair market price for hosiery "in the grey" but not less than petitioner's total costs which were attributable to production of the hosiery "in the grey," plus such other charges as petitioner might have incurred after the point of manufacture. The amount so "billed" was remitted to petitioner by Hosiery out of the sales proceeds received from National, and the balance was retained by Hosiery as its "profit" or "com-

pensation." There were inter-company accounts between Hosiery and petitioner, and when remittance by check was received by Hosiery from National, Hosiery in turn might indorse the check to petitioner in liquidation of those accounts. (R. 160–161.)

Petitioner at all times retained title to the hosiery when finished, and, in fact, Hosiery never purchased or acquired any hosiery from petitioner. The hosiery involved belonged to petitioner, and was sold by National's sales organization, except in the case of several large purchasers who dealt directly with the Goodmans or Kobin, purporting to represent Hosiery. But even in the latter situation it was petitioner's hosiery that was being sold. (R. 161.)

The only other function performed by Hosiery in relation to the petitioner's product was to provide styling and "merchandising" services, which were rendered by L. L. Goodman, J. A. Goodman, and Kobin, who, in rendering these services, were acting as employees of Hosiery. Neither the nominal partners nor any other employees of Hosiery rendered any services of consequence in relation to petitioner's product. (R. 161–162.)

During the tax years in question, the Goodmans and Kobin received salaries paid by Hosiery, which were established with their agree-

263294—53——2

ment. They took part in deciding what the amounts, which were considered fair salaries, would be. For the fiscal year ended June 30, 1941, the partnership return of Hosiery disclosed salaries and wages in the aggregate amount of $82,908.44, substantially all of which was paid to the Goodmans and Kobin. The aggregate wages and salaries similarly paid by Hosiery for the succeeding fiscal years ending June 30, were as follows: 1942, $20,000; 1943, $8,151.29; 1944, $8,320. (R. 163.)

From at least July 1, 1940, to the latter half of 1943, the J. A. Goodman, L. L. Goodman, and Kobin families and Barskin were the record owners of all the common stock of petitioner and National, substantially all the preferred stock of petitioner and National, and the entire partnership interests in Hosiery and Abar Processing Company (see p. 2, n. 1, *supra*). During this period, the proportionate interests of the J. A. Goodman, the L. L. Goodman, the Kobin families, and Barskin were, with insignificant variation, identical in the common stock of petitioner, the common stock of National, and in the Hosiery and Abar partnerships, as follows: J. A. Goodman family—35 percent; L. L. Goodman family—35 percent; Kobin family—20 percent; Barskin—10 percent. (R. 143–146, 150–151, 166–167, 168.) These interests in the common stock of petitioner and National continued unchanged during 1943 and throughout

the remainder of the tax years here in issue; but a slight change in the Hosiery and Abar partnerships in the latter part of 1943 was caused by the admission of one Ronia Solar to a 9.09 percent interest in each. (R. 168–169.)

Hosiery's "Gross receipts from business or profession," its "net" income as reported on its returns, and its "net" income as adjusted by the Commissioner, were as follows (R. 170):

Year ended June 30	Gross receipts from business or profession	Net income	Net income as adjusted
1941	$1,933,429.92	$101,928.57	$103,486.30
1942	1,638,882.38	2,533.17	4,033.24
1943	1,203,672.35	48,415.96	49,916.38
1944	1,585,425.38	53,473.38	53,473.38

These reports of gross receipts consisted largely, if not entirely, of the receipts from the sales of petitioner's hosiery. To arrive at net income on Hosiery's returns, large amounts were subtracted each year ($1,631,293.46 for 1941, $1,478,748.81 for 1942, $1,071,262.49 for 1943, and $1,492,153.36 for 1944) as the cost of "merchandise bought for sale," notwithstanding the fact that Hosiery never bought any goods for sale. (R. 170.)

The Commissioner attributed to Hosiery an annual allowance of 10 percent on a capital of $4,286.25, amounting to $428.63, plus $1,000 as salary for Barskin. The remainder of Hosiery's

adjusted income was allocated to petitioner in the following amounts (R. 171):[4]

Year ended Mar. 31	
1941	$62,068.57
1942	29,164.11
1943	30,189.53
1943	45,893.73

The notice of deficiency sent to the petitioner notified it that portions of the gross income attributed to Hosiery had been allocated to the petitioner pursuant to Section 45 (R. 172). Although the notice of deficiency did not show the

[4] The Commissioner also allocated a portion of Hosiery's income to National (R. 171). But the Tax Court disallowed this allocation, holding that National received a fair price, including a reasonable profit, for the dyeing, finishing, and sales services which it rendered with respect to petitioner's product. National's earnings were, accordingly, accurately reflected in its returns, and there was no basis to attribute to National any additional profits. (R. 185–186.) The Commissioner did not appeal this aspect of the decision.

In 1942 the same interests organized the Abar Processing Company to engage in the salvage of hosiery waste, an operation for which neither the petitioner nor National was equipped. Both the petitioner and National sold their waste to Abar and purchased reclaimed yarn from it (R. 167–168). The Commissioner allocated the income which Abar reported (after attributing to it an annual allowance of $1,000 on its capital investment of $1,000, plus a salary of $1,000 for Barskin) to the petitioner and National (R. 171). The Tax Court, however, held that Abar performed a separate and distinct function within the industry, which neither National nor the petitioner had ever entered, and that Abar paid and received fair market prices as though its transactions had been carried on with strangers (R. 178–179). Accordingly, the Tax Court disallowed the allocation to the petitioner, and the Commissioner did not appeal this aspect of its decision.

method of allocation of the income, the revenue agent's reports on petitioner allocated to that company precisely the same amounts of Hosiery's income as were allocated on the notice of deficiency. These reports showed the computations by which the allocations were reached. (R. 172.)

The Tax Court found that all the organizations were owned or controlled directly or indirectly by the same interests within the meaning of Section 45, and that all the organizations were dominated primarily by the two Goodmans and to a lesser degree by Kobin and Barskin. The Tax Court further found that the Commissioner's allocation of Hosiery's income to the petitioner was reasonable and was necessary to prevent evasion of taxes or clearly to reflect petitioner's income. The value of the services rendered by Hosiery to the petitioner was held to be no greater than the salaries and wages paid by Hosiery during each of the years involved. (R. 172–173.)

Upon petitioner's appeal, the Court of Appeals for the Fifth Circuit noted its "complete agreement" with the "excellent opinion" of the Tax Court and, affirming for the reasons given in that opinion, stated that (R. 502):

> A careful examination of the Tax Court's thorough and painstaking analysis of the facts and its equally thorough discussion and exposition of the meaning and effect of Section 45, as applied to the facts of

this case, convinces us that the facts have been correctly apprehended and stated, and the law as correctly applied to them.

ARGUMENT

The decision below is correct, turns on the particular facts of this case, and presents no question warranting further review by this Court.

1. Whether the Tax Court was correct in allocating income to taxpayer under Section 45 of the Internal Revenue Code (Appendix, *infra,* p. 18) is essentially a question of fact. Unless the decision of the Tax Court was clearly erroneous, the court below was bound to affirm. Rule 52 (a), Federal Rules of Civil Procedure. *Asiatic Petroleum Co.* v. *Commissioner,* 79 F. 2d 234 (C. A. 2), certiorari denied, 296 U. S. 645, rehearing denied, 296 U. S. 664; *National Securities Corp.* v. *Commissioner,* 137 F. 2d 600 (C. A. 3), certiorari denied, 320 U. S. 794; *Advance Machinery Exch.* v. *Commissioner,* 196 F. 2d 1006 (C. A. 2), certiorari denied, 344 U. S. 835. Indeed, the Tax Court's own review of the Commissioner's determination under Section 45 is not *de novo* (R. 177), for the statute vests him with discretion, which may not be reversed by the Tax Court, unless proved by taxpayer to be arbitrary. *G. U. R. Co.* v. *Commissioner,* 117 F. 2d 187 (C. A. 7); *National Securities Corp.* v. *Commissioner, supra; Commissioner* v. *Chelsea Products,* 197 F. 2d 620, 624 (C. A. 3).

Here the court below properly concluded that the Tax Court had meticulously and correctly determined the facts (R. 502). Indeed, for the purpose of its petition here, taxpayer now concedes (Pet. 4, n. 1) the Tax Court's factual conclusion (R. 175) that Hosiery and taxpayer were controlled by the same interests within the meaning of Section 45. For the rest, the Tax Court analyzed the evidence in great detail to determine, as required by the statute and pertinent Treasury Regulations 111, Section 29.45–1 (Appendix, *infra,* pp. 18–22), according to the standard of an uncontrolled taxpayer, the true net income from the business of the controlled taxpayer, so as to ascertain whether by inadvertence or design the taxable net income of the controlled taxpayer was other than it would have been had taxpayer been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer (R. 177–178, 179–186). *Commissioner* v. *Chelsea Products, supra; Central Cuba Sugar Co.* v. *Commissioner,* 198 F. 2d 214 (C. A. 2), certiorari denied, 344 U. S. 874.

Despite petitioner's contentions (Pet. 2, 10, 11–14, 19), there is ample record support for the factual conclusions by the courts below as to the shifting of income from the one controlled unit to the other. The Tax Court examined the functions performed by Hosiery, in order to determine whether income really earned by petitioner had been artificially diverted to Hosiery.

It found that Hosiery's operations consisted almost entirely of part-time services rendered by the two Goodmans and Kobin, and that capital was not a factor (R. 179–180). None of the record partners in Hosiery performed services (R. 180). The Goodmans and Kobin as employees of Hosiery did furnish ideas for design, styling and merchandising of petitioner's product and in addition procured several large purchasers for its goods. Hosiery did not otherwise do any selling for petitioner and the great bulk of its sales was made by National, for which National was paid. (R. 180–181.)

The Tax Court also concluded that petitioner did not sell its hosiery "in the grey," but shipped it to National for dyeing and finishing, for which it paid standard charges, at all times retaining title to its product. Neither did Hosiery buy petitioner's product for resale nor guarantee that petitioner would receive any fixed return on its product. Hence, petitioner was entitled to receive the full price paid for its finished product minus such fair charges as were incurred for dyeing, finishing and sales service furnished by National minus also such fair charges for styling, merchandising and other services actually rendered by Hosiery. (R. 180–182.)

Accordingly, on the evidence, the courts below were clearly correct in concluding that the fair value of the services rendered by Hosiery was solely the fair value of the services rendered by

the two Goodmans and Kobin as its employees and that this value was measured by the salaries paid by Hosiery to these employees (R. 182–183).

Nor is there any basic difference, as petitioner contends (Pet. 8), between the method used by the Tax Court and that used by the Commissioner. In the final analysis, both attributed to Hosiery the salaries paid to its employees. As the Tax Court pointed out (R. 185): "in essence, [the Commissioner] did substantially" what the Tax Court approved—allocate to petitioner the gross income to the extent that the gross income in fact exceeded the fair value of the services rendered by Hosiery to petitioner (after making an allowance of a 10 percent return on the partners' capital).

2. Contrary to petitioner's contention (Pet. 14–19), there is no conflict of decisions requiring resolution by this Court.

Unlike *Chelsea Products, supra* (where, as here, the reviewing court of appeals affirmed the factual conclusions of the Tax Court), the Commissioner's notice of deficiency here specifically indicated that he had made his determination under Section 45 and, moreover, that his allocation was of Hosiery's "gross," not "net," income (R. 172). In this connection, the Tax Court also correctly disposed of petitioner's claim (Pet. 14–15) that net income was allocated. Thus, Hosiery's returns, based upon the invalid assumption that it sold its own goods, did not present a

true picture of the relationship between the organizations. A revision of those returns was necessary in order to achieve such a presentation. And the deficiencies actually assessed against petitioner were no greater than they would have been had Hosiery filed its returns accurately setting forth its gross income, and had the Commissioner made explicit allocation of portions of those amounts.[5] (R. 184–185.)

Finally, the decision below is inconsistent with neither *National Carbide Corp.* v. *Commissioner,* 336 U. S. 422, nor *Helvering* v. *Taylor,* 293 U. S. 507. In the latter it was held that the burden of proof was on the taxpayer to show that the Commissioner's determination was invalid (293 U. S. at 515), but it was assumed by the Court and the parties that the evidence showed such an erroneous determination (*id.* at 511). Here, of course, the taxpayer failed to show that the Commissioner's allocation of income was erroneous. The former involved only the question of whether wholly owned subsidiaries could be taxed upon income actually earned by them and turned over to the parent in accordance with contractual arrangements. No question of the power of the

[5] Contrary to petitioner's suggestion (Pet. 15–16), there is no conflict between the *Chelsea Products* case and *Advance Machinery Exchange Corp.* v. *Commissioner, supra,* which are widely dissimilar on their facts upon an issue essentially factual in nature. This Court denied certiorari in *Advance Machinery Exchange,* 344 U. S. 835, despite the petitioner's urging there of a conflict with *Chelsea Products.*

Commissioner to allocate gross income or expenses under Section 45, as between organizations under the control of the same interests, was in issue before this Court. Cf. 336 U. S. at 433–434, n. 13.

CONCLUSION

This case turns upon its own facts; there is no conflict of decisions; and the decision of the Court of Appeals, affirming the Tax Court, which had sustained the Commissioner's determination, is correct. The petition for writ of certiorari should be denied.

Respectfully submitted,

OSCAR H. DAVIS,
Acting Solicitor General.
H. BRIAN HOLLAND,
Assistant Attorney General.
ELLIS N. SLACK,
I. HENRY KUTZ,
Special Assistants to the Attorney General.

JULY 1953.

APPENDIX

Internal Revenue Code:

SEC. 45. ALLOCATION OF INCOME AND DEDUCTIONS.[1]

> In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.
> (26 U. S. C. 1946 ed., Sec. 45.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

> SEC. 29.45–1. *Determination of the Taxable Net Income of a Controlled Taxpayer.*—(a) *Definitions.*—When used in this section—
>
> (1) The term *"organization"* includes any organization of any kind, whether it

[1] Section 128 (b) of the Revenue Act of 1943, c. 63, 58 Stat. 21, amended Code Section 45 by striking out the words "gross income or deductions" and inserting in lieu thereof "gross income, deductions, credits, or allowances." The change was effective, under Section 128 (c) of the Revenue Act of 1943, with respect to tax years beginning after December 31, 1943.

be a sole proprietorship, a partnership, a trust, an estate, or a corporation (as each is defined or understood in the Internal Revenue Code or these regulations), irrespective of the place where organized, where operated, or where its trade or business is conducted, and regardless of whether domestic or foreign, whether exempt, whether affiliated, or whether a party to a consolidated return.

(2) The terms *"trade"* or *"business"* include any trade or business activity of any kind, regardless of whether or where organized, whether owned individually or otherwise, and regardless of the place where carried on.

(3) The term *"controlled"* includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted.

(4) The term *"controlled taxpayer"* means any one of two or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests.

(5) The terms *"group"* and *"group of controlled taxpayers"* mean the organizations, trades, or businesses owned or controlled by the same interests.

(6) The term *"true net income"* means, in the case of a controlled taxpayer, the net income (or, as the case may be, any item or element affecting net income) which would have resulted to the controlled taxpayer, had it in the conduct of its affairs (or, as the case may be, in the particular contract, transaction, arrange-

ment, or other act) dealt with the other member or members of the group at arm's length. It does not mean the income, the deductions, or the item or element of either, resulting to the controlled taxpayer by reason of the particular contract, transaction, or arrangement, the controlled taxpayer, or the interests controlling it, chose to make (even though such contract, transaction, or arrangement be legally binding upon the parties thereto).

(b) *Scope and purpose.*—The purpose of section 45 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true net income from the property and business of a controlled taxpayer. The interests controlling a group of controlled taxpayers are assumed to have complete power to cause each controlled taxpayer so to conduct its affairs that its transactions and accounting records truly reflect the net income from the property and business of each of the controlled taxpayers. If, however, this has not been done, and the taxable net incomes are thereby understated, the statute contemplates that the Commissioner shall intervene, and, by making such distribution, apportionments, or allocations as he may deem necessary of gross income or deductions, or of any item or element affecting net income, between or among the controlled taxpayers constituting the group, shall determine the true net income of each controlled taxpayer. The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

Section 45 and this section apply to the case of any controlled taxpayer, whether such taxpayer makes a separate or a consolidated return. If a controlled taxpayer makes a separate return, the determination is of its true separate net income. If a controlled taxpayer is a party to a consolidated return, the true consolidated net income of the affiliated group and the true separate net income of the controlled taxpayer are determined consistently with the principles of a consolidated return.

Section 45 grants no right to a controlled taxpayer to apply its provisions at will, nor does it grant any right to compel the Commissioner to apply such provisions. It is not intended (except in the case of the computation of consolidated net income under a consolidated return) to effect in any case such a distribution, apportionment, or allocation of gross income, deductions, or any item of either, as would produce a result equivalent to a computation of consolidated net income under section 141.

(c) *Application.*—Transactions between one controlled taxpayer and another will be subjected to special scrutiny to ascertain whether the common control is being used to reduce, avoid, or escape taxes. In determining the true net income of a controlled taxpayer, the Commissioner is not restricted to the case of improper accounting, to the case of a fraudulent, colorable, or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income or deductions. The authority to determine true net income extends to any case in which either by inadvertence or design the taxable net income, in whole or in part, of a controlled

taxpayer, is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

The provisions of Section 19.45–1 of Treasury Regulations 103, promulgated under the Internal Revenue Code, are substantially the same as Section 29.45–1 of Treasury Regulations 111.

U. S. GOVERNMENT PRINTING OFFICE: 1953

Office - Supreme Court, U. S.
FILED
AUG 28 1953
HAROLD B. WILLEY, Clerk

Supreme Court of the United States

October Term, 1953

No. 124

GRENADA INDUSTRIES, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

REPLY BRIEF FOR PETITIONER

ROBERT A. LITTLETON
PHILIP B. PERLMAN
Suite 1021,
Tower Building,
Washington 5, D. C.
ARTHUR L. GILLIOM,
ELBERT R. GILLIOM,
Suite 1344,
Consolidated Building,
Indianapolis, Indiana,
Attorneys for Petitioner.

Of Counsel:
SAMUEL J. MANTEL,
Of Indianapolis, Indiana.

WILSON - EPES PRINTING CO. - RE 7-6003 - WASHINGTON 1, D. C.

In The

Supreme Court of the United States

Grenada Industries, Inc.,
Petitioner,

vs.

Commissioner of Internal Revenue,
Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

REPLY BRIEF FOR PETITIONER

ARGUMENT

Respondent's contention in his brief in opposition to the petition that the case does not present any question warranting further review, that it is not in conflict with the decisions mentioned in the petition, and was correctly decided upon its facts is based on the erroneous assumption made in his argument that The Tax Court made factual findings to the effect that the allocations in question were items of Hosiery's "gross income" and that they were based on the "standard of an uncontrolled taxpayer" dealing at arm's length with another "uncontrolled taxpayer" which Section 29.45-1 of Treasury Reg-

ulations 111 prescribes and directs shall be applied and followed in every case where allocation is permissible under Section 45 of the Code.

It is shown in the Statement in the petition that the allocations were of Hosiery's "adjusted net income" rather than of "items of gross income", and that the Commissioner made them on the basis of allowing to Hosiery an annual return of $428.63, at the rate of 10% on its capital of $4,286.25, as and for its net profit, which amounted to less than 1% of its net income for the four year period involved. It is there also shown that the basis used by the Commissioner was not the basis on which uncontrolled taxpayers deal with each other in the hosiery industry, also that it was not the basis on which the petitioner and Hosiery earned their respective incomes from the joint enterprise under their contract of June 24, 1940. (Pet. 5-8)

Neither Section 29.45-1 of the Regulations nor the arm's length standard therein prescribed are anywhere mentioned in The Tax Court's findings of fact (R. 135-173) or in its opinion (R. 173-186), and there is no finding whatever as to what the usual basis in the hosiery industry was on which independent gray hosiery manufacturers deal and on which they earn their incomes and profits. The petitioner, however, proved by uncontradicted and undisputed evidence that there are more than 200 gray hosiery manufacturers in this country who confine their facilities and business to the manufacture of hosiery in the unfinished gray stage, the same as the petitioner did, and who always earn their entire incomes and profits on the basis of receiving market price for their gray hosiery. (R. 247, 461). The Court found there always is a market for gray hosiery (R. 135), and that in the settlements with Hosiery the petitioner always received amounts equivalent to the fair market

price for gray hosiery applied to quantities invoiced by it to Hosiery. (R. 161).

The Courts below interpreted Section 45 of the Internal Revenue Code as authorizing the allocations in question in the exact amounts as the Commissioner computed and made them. The Tax Court's findings of fact show beyond cavil that as a matter of indisputable fact the thing allocated in each of the years involved was the ascertained *net* income of the partnership Hosiery, and that they were made on his arbitrary basis of allowing to Hosiery out of its own net income an annual return of 10% on its capital. The amounts allocated to the petitioner and to National are set out at page 171 of the record as constituting the remainder of Hosiery's *"Net Income As Adjusted"*, shown at page 170 of the record. It is there shown that before the allocations were made the Commissioner actually *increased* Hosiery's reported net income by adjusting the same *upward* to the figures set out in the findings under the above quoted heading. (R. 170).

Moreover, The Tax Court found that these allocated amounts are identical with those allocated in the Revenue Agent's reports in the evidence, and "that these reports show the computations by which these allocations were reached". (R. 172). The Revenue Agent's report on the petitioner (Exhibit 16) shows that the Commissioner used the following method and computation for making the allocations: First, he adjusted Hosiery's net income for its fiscal years ended June 30, 1941-1944 so as to conform the same to petitioner's fiscal years ended on March 31 of those years; he then made a deduction of $428.63 a year for "10% on Investment of $4,286.25", and a deduction of $1,000 a year for "Salary allowed A. J. Barskin"; the remainder of Hosiery's net income was then allocated as *"Net income to be allocated on cost*

of production'', 585/666 to the petitioner and 81/666 to National; the amounts so computed and added to petitioner's net income are described in the Agent's report as *"Excessive profits''* of the partnership Hosiery.

In his deficiency notice the Commissioner termed the amounts thus computed and allocated to the petitioner as being portions of Hosiery's "gross" income. This circumstance is seized upon by respondent (Br. 15) as the basis for his contention that this case is not in conflict with the decision in *Commissioner* v. *Chelsea Products, Inc.*, 3 Cir. 197 F. (2d) 620, that Section 45 of the Code did not authorize the allocation of the net incomes of three controlled corporations to a fourth controlled corporation. It has been demonstrated from the record that the instant allocations are of "net" income and were made by the Commissioner on the theory that Hosiery had in his opinion made too large a profit in relation to the amount of its invested capital. The Revenue Agent's report shows that the Commissioner did not purport to allocate "gross" income and that the basis, method and computations used were wholly unsuited for allocating "gross" income. Merely labeling the amounts so allocated as "gross" income does not make them such. The Tax Court took note in its opinion that in the deficiency notice the allocated amounts are referred to as "gross" income, and that in the Revenue Agent's reports they are called "net" income, and said that this causes "confusion in the record as to the label to be applied" thereto (R. 184), but that it thought the Commissioner had "in essence" allocated "gross" income. (R. 185). The Commissioner's use of the "gross" income label in his deficiency notice does neither efface nor obscure the reality revealed by the computations, method and basis used by him that he in fact avowedly allocated *net* income and nothing else.

In his deficiency notice the Commissioner asserted, in the alternative, that the same identical amounts of Hosiery's income which he allocated to the petitioner under claimed authority of Section 45 of the Internal Revenue Code were taxable to the petitioner under the provisions of Section 22(a) of the Code upon his holding "that said purported partnership is without substance". (R. 96). The Tax Court rejected this Section 22(a)—based alternative (R. 173), but under its interpretation of Section 45 of the Code it reached exactly the same result as if said amounts were taxed to the petitioner under Section 22(a). The Tax Court found that the partnership Hosiery and the petitioner were *"separately existing and functioning organizations, trades or businesses"* controlled by the same organizations (R. 172), which kept "separate books of account" (R. 167) and held that Hosiery was a "valid" partnership which played "real parts in the hosiery business" (R. 135), and was entitled to recognition as a "separate entity". (R. 180). The Court of Appeals concurred in The Tax Court's interpretation and application of Section 45. (R. 502).

It is thus clear that the question stated at page 2 of the petition concerning the interpretation of Section 45 is presented in this case and warrants consideration and decision by this Court for the reasons stated at pages 11-14 of the petition.

It is also clear, as pointed out at pages 14-16 of the petition, that the interpretation and application given in this case to Section 45 of the Code is in conflict with the interpretation and application given to the same section by the Court of Appeals for the Third Circuit in *Commissioner* v. *Chelsea Products, Inc.*, 197 F. (2d) 620.

The conflict of this case with the principle of *National Carbide Corporation* v. *Commissioner*, 336 U. S. 422, 93 L. Ed. 799, in the respect pointed out at pages 16-17 of

the petition exists notwithstanding respondent's point (Br. 16-17) that *National Carbide* did not involve Section 45. It is clear that if in that case the Commissioner had allocated and taxed to *Airco* the net incomes of its subsidiaries it would follow from the Court's reasoning in the opinion that such allocation would not have been authorized by Section 45. For all practical tax purposes the allocation of more than 99% of Hosiery's *net* income to others is a complete disregard of Hosiery as a separate entity. The yearly amount of $428.63 allowed it as a return on its capital, when service, not capital, produced the income, was of no practical tax consequence to anyone and might as well have gone with the 99%. It is clear that this case conflicts with the principles of *National Carbide.*

Respondent's contention that the burden of proof question stated at page 2 of the petition is not present, and that there is no conflict with this Court's decision on burden of proof in *Helvering* v. *Taylor,* 293 U. S. 507, is based on the assumption that the petitioner failed to show that the allocations in question were erroneous. (Br. 16). The Tax Court's findings of fact themselves show that these allocations were not made on the standard prescribed for every case in Section 29.45-1 of Treasury Regulations 111. The Regulations expressly provide that:

> "The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer."

The findings show that the allocations were made on the basis of allowing to Hosiery out of its own net income only a yearly amount of $428.63 at 10% on its invested capital as and for its net profit (R. 171), notwithstanding the finding that in Hosierys trade and business "Capital was not a factor in the operation of Knitting or Hosiery". (R. 153). The Tax Court further found that the enterprise from which the income was derived was a

new enterprise launched for manufacturing, finishing, merchandising and selling a new type of ladies full-fashioned hosiery known as the "single-unit" type (R. 141), "the quality and worth of which had to be proven to the trade and a market for which had to be created" (R. 163); that the enterprise was conducted under the terms of a written contract entered into on June 24, 1940 between Hosiery and the petitioner for a term of five years extending to June 30, 1945, which is set out in full in the findings. (R. 154-159). The contract assigned to the petitioner the phase of the enterprise consisting of manufacturing the hoosiery in the gray unfinished stage, and assigned to the partnership Hosiery the phases consisting of the supervision of "the finishing, merchandising and sale of such hosiery either by developing the facilities for so doing, or by engaging facilities for the purpose". (R. 155). The contract provided that each should share, in amounts to be determined by agreement or by arbitration from time to time, in the gross profits of the enterprise under a formula provided in the contract. (R. 156-158). In practice consistently followed throughout the entire term of the contract, covering all tax years involved, they made settlements between themselves on invoices whereby the petitioner received amounts equivalent to the fair market price for hosiery in the gray unfinished stage in which it manufactured them (R. 161), which is the basis on which more than 200 manufacturers of gray hosiery earn their entire incomes and profits (R. 247, 461). The Court found that the partnership Hosiery employed L. L. Goodman, J. A. Goodman and H. V. Kobin, all experts in the hosiery business, and paid for their expert services, to enable it to perform the phases of the joint enterprise which the contract assigned to it and that through its said experts Hosiery performed important functions and services in the phases of the enterprise assigned to it, which were particularly im-

portant in view of the novelty of this new type hosiery and of the necessity to create a market therefor. (R. 162).

From the foregoing findings it is clear that the basis on which the Commissioner made said allocations was not on the standard prescribed in Section 29.45-1 of the Regulations, and was an extremely capricious and arbitrary basis chosen by himself without any warrant therefor in the facts. The respondent says the allocation method used by The Tax Court was not basically different from that used by the Commissioner and that "in the final analysis, both attributed to Hosiery the salaries paid to its employees". (Br. 15). The methods were different, but the end results of their use were not materially different. The "fair charge" basis used and applied by The Tax Court was no less arbitrary than that used by the Commissioner. That was not the arm's length standard on which uncontrolled taxpayers similarly situated in the hosiery industry deal with one another, and it was adopted by The Tax Court as a result of its misconstruction of the written point venture contract of June 24, 1940 and is at complete variance with the profit sharing provisions of the contract and with the practical settlements which the parties thereto made in harmony with arm's length standards of uncontrolled taxpayers similarly situated in the hosiery industry.

In addition to said erroneous "fair charge" guide, The Tax Court's method involved its obviously unsupported and arbitrary conclusion in its findings of fact that the services furnished by the partnership Hosiery throughout the four tax years involved were not worth more "than the salaries and wages paid by Hosiery during each of the years involved". (R. 173). This conclusion that this recognized "valid" and "functioning" partnership which "rendered valuable services" (R. 173) in its

performance of the necessary and highly important phases of the enterprise assigned to it in the contract should have as its reward for a four-year period of service only a recoupment of the out-of-pocket expenses paid out by it in furnishing the services has no support in any factual findings or in any evidence in the record, and is on its face arbitrary. Under that conclusion the partnership would not even be entitled to the mite of $428.63 which the Commissioner had arbitrarily allowed it as and for its net profit of 10% on its capital.

The decision of the Court of Appeals, approving in all things the decision and opinion of The Tax Court, imposed on the petitioner a broader burden than the rule of *Helvering* v. *Taylor* required. Under that rule the petitioner was entitled to have the Commissioner's determination set aside upon proof that it was arbitrary, without furnishing evidence upon which some other determination could be made. Contrary to that rule, the opinion of The Tax Court charged the petitioner with the burden of proving the value of Hosiery's services as a basis for determining what amounts, if any, of Hosiery's "adjusted net income" should be allocated and taxed to the petitioner. (R. 183-185). In so holding The Tax Court gave tacit recognition to the fact that the Commissioner's determination of allocations on the basis of a 10% return to Hosiery and of 585/666% of the remainder of its "adjusted net income" to petitioner was arbitrary and indefensible.

Indeed, the allocation to National of 81/666% of the "adjusted net income" of Hosiery (*arbitrarily earmarked for allocation by the Commissioner*) was disapproved as arbitrary in a free economy (R. 185-186) on the standard applicable to uncontrolled taxpayers; and on the postulate (R. 181) that the agreement of June 24, 1940 (R. 155) between petitioner and Hosiery applies the customary standard of the hosiery industry that is followed consist-

ently in the industry by *uncontrolled taxpayers* (R. 161, 247, 461) dealing at "arm's length", a proper construction of Section 45 of the Code would make the allocation of 585/666% of the "adjusted net income" of Hosiery (arbitrarily earmarked for allocation by the Commissioner to petitioner) as much an arbitrary departure from the *standard applicable* to *uncontrolled taxpayers* in the case of petitioner as it is found by The Tax Court to be in the case of National. (R. 185-186).

A mathematical *formula* of 585/666% or 81/666% of the "adjusted net income" of Hosiery (earmarked by the Commissioner for allocation to petitioner and National), and a *formula* of 10% "of the invested capital of Hosiery" devised by the Commissioner for allocation of the remainder of such "adjusted net income" to Hosiery, presents a wide departure from the basic purpose of Section 45 of the Code. In the whole history of Section 45 of the Code, no such *formulae* for its application have ever been attempted by the Commissioner and/or approved by the Courts in adjudicated cases; and if such formulae appear absurd in the case of National, it is likewise absurd in the case of petitioner. The law requires only that *controlled taxpayers* apply the standards of *uncontrolled taxpayers* "in a free economy". The Tax Court holds (R. 181) that if the contract of June 24, 1940 (R. 155) had existed between *uncontrolled taxpayers* it would be recognized as an "arm's length transaction"; but inasmuch as it was between controlled taxpayers it may not be *so recognized*. The reasons for the *distinction* (passing of title to gray hosiery from petitioner to Hosiery) is insignificant under the legal scope of the purpose of Section 45 of the Code, as construed by Sections 29.45-1 of Regulations 111. The law takes into account that in the case of *controlled taxpayers* the standard of *uncontrolled taxpayers* be applied; and on the record, pp. 161, 247, 461, the Court *finds and holds* (R. 181) that

the standards of *uncontrolled taxpayers* were applied under the agreement of June 24, 1940 except for the incident of "passing of title" to the "gray hosiery" from petitioner to Hosiery. When a fair price for property is fixed and agreed to between uncontrolled taxpayers title thereto passes automatically upon delivery in the case of personalty and may be *acquired* by *specific* performance in the case of realty. In the case of controlled taxpayers the title to property that they produce for sale by their joint efforts is common to each; but the standard of the interest of each in the property is the standard that The Tax Court finds to be applicable in the case of *uncontrolled taxpayers.* (R. 181). (See *North Carolina Lumber Co.* v. *Commissioner,* 19 T.C. ..... No. 74, decided September 31, 1952, CCH Decision No. 19,373).

Section 45 of the Code goes no further, and furnishes no other standard or definition for the adjustment of transactions between *controlled taxpayers* than a standard that is applicable to *uncontrolled taxpayers* dealing with each other at arm's length as to gross income, deductions, credits and allowances of each in arriving at true "net income" of each; and it would be a strained construction, in the absence of a definition by Congress, to impute to the terms "gross income", "deductions", "credits", or "allowances" a meaning of broader significance than the terms themselves warrant. (See Section 29.45-1 of Regulations 111). The attempt of the Commissioner, as approved by the Courts below in this proceeding, to *impute* a new meaning to the terms "gross income" and "deductions" (as used by the Congress in Section 45 of the Code) is clearly *arbitrary* and *capricious,* and amounts to a misapplication of the section. (See *Chelsea Products, Inc., supra*). Such terms do not "in essence" mean "adjusted net income" of one or more of two related businesses; and they may not be said "in

essence" to embrace the term "adjusted net income" of one of two or more trades or businesses, unless Section 45 of the Code may be construed to authorize the Commissioner to *arbitrarily* and *capriciously* allocate the "adjusted net income" of one of two or more trades or businesses in lieu of the limitations imposed upon him by the plain language of said section. The Courts below have committed grievous error by approving a method for taxing "adjusted net profits" of controlled taxpayers that is held by this Honorable Court to be *unauthorized* in the case of *National Carbide Corporation, supra.* Section 45 of the Code may not be construed to mean that the "adjusted net profits" of controlled taxpayers may be arbitrarily shifted by the Commissioner, as proposed by the Courts below.

Controlled taxpayers, of which there are many "in a free economy", should have a guide so as to be able to avoid an *infringement* of Section 45 of the Code. The decision of The Tax Court herein as affirmed by the Court of Appeals destroys the guide of *"controlled taxpayers"* that the petitioner thought it could apply "in a free economy" under the terms and conditions of the agreement of June 24, 1940. (R. 155, 161, 247, 461).

The agreement of June 24, 1940 is found by The Tax Court to be legal and it cannot escape being considered as substantial proof of the "value of the services of Hosiery" to the joint enterprise thereof in a "free economy" if it were between *uncontrolled taxpayers.* (R. 181).

The confusion caused by the respondent's allocations, and the reversal or modification of his determinations by The Tax Court, have left the parties concerned in an impossible position. (R. 171, 185-186). That part of Hosiery's adjusted net income for the years in question

which the Commissioner purported to allocate to National in the aggregate of $20,125.47 (R. 12) is now taken away from National by The Tax Court and the Court of Appeals. (R. 185-186). But the Courts below also decided that Hosiery could not earn more than $428.63 annually in its trade or business. (R. 171). Therefore, although the partners of Hosiery have already paid the tax on the "adjusted net income" of Hosiery that is allocated by respondent to National, the Courts below have decided that such part of Hosiery's net income should not be taxed against Hosiery or National. (R. 171, 185-186). As the case now stands Hosiery can earn no more than a nominal net income annually of 10% on its invested capital of $4,286.25; so that, unless the case is reversed, a part of Hosiery's "adjusted net income" for the years in question will be taxed against petitioner, and the balance of $20,125.47 *may not be taxed at all.* (R. 12, 171, 185-186). Certainly Section 45 of the Code and Section 29.45-1 of Regulations 111 do not contemplate such a ridiculous result. Such result is a consequence of the capricious arbitrary and illegal interpretation of Section 45 of the Code and Section 29.45-1 of Regulations 111; and the ultimate effect of the decision of the Courts below is that the provisions of Sections 181, 182 and 183 of the Code, which provide the method for taxing the "adjusted net income" of Hosiery, *must be ignored entirely.* Therefore, inasmuch as the decision of the Courts below immunize $20,125.47 of the "adjusted net income" of Hosiery from tax, as provided by Sections 181, 182 and 183 of the Code, it cannot escape the feature of being arbitrary and capricious. This is a result of an attempt to allocate "net income" rather than "gross income" of two or more trades or businesses, and proves conclusively a misinterpretation of Section 45 of the Code by the Courts below.

CONCLUSION

We submit that the memorandum brief of respondent in support of his opposition to the petition herein does not adequately uphold the decision of the Courts below as a proper construction and application of Section 45 of the Code.

Respectfully,

ROBERT A. LITTLETON
PHILIP B. PERLMAN
1021 Tower Building
Washington, D. C.

ARTHUR L. GILLIOM,
ELBERT R. GILLIOM,
1344 Consolidated Building
Indianapolis, Indiana.
Attorneys for Petitioners